

Department of the Navy Subsidiary Financial Statements

Navy Working Capital Fund – Marine Corps
Principal Statements

2006



2006 Annual Financial Report 2006 Annual Financial Report
2006 Annual Financial Report 2006 Annual Financial Report
2006 Annual Financial Report 2006 Annual Financial Report
2006 Annual Financial Report 2006 Annual Financial Report
2006 Annual Financial Report 2006 Annual Financial Report
2006 Annual Financial Report 2006 Annual Financial Report
2006 Annual Financial Report 2006 Annual Financial Report
2006 Annual Financial Report 2006 Annual Financial Report
2006 Annual Financial Report 2006 Annual Financial Report
2006 Annual Financial Report 2006 Annual Financial Report
2006 Annual Financial Report 2006 Annual Financial Report
2006 Annual Financial Report 2006 Annual Financial Report
2006 Annual Financial Report 2006 Annual Financial Report
2006 Annual Financial Report 2006 Annual Financial Report
2006 Annual Financial Report 2006 Annual Financial Report
2006 Annual Financial Report 2006 Annual Financial Report
2006 Annual Financial Report 2006 Annual Financial Report
2006 Annual Financial Report 2006 Annual Financial Report



Limitations to the Financial Statements

The principal financial statements have been prepared to report the financial position and results of operations of the entity, pursuant to the requirements of 31 U.S.C. 3515 (b). While the statements have been prepared from the books and records of the entity in accordance with GAAP for Federal entities and the formats prescribed by OMB, the statements are in addition to the financial reports used to monitor and control budgetary resources which are prepared from the same books and records. The statements should be read with the realization that they are for a component of the U.S. Government, a sovereign entity.

In Fiscal Year (FY) 2006, the Office of the Under Secretary of Defense (Comptroller), with support from the Department of the Navy, designated the U.S. Marine Corps a financial reporting entity. This designation allowed the Marine Corps to prepare comprehensive subsidiary financial statements and related notes beginning in Fiscal Year 2006.

The Marine Corps shares appropriations with the Department of the Navy and maintains accountability for its own appropriations. The Marine Corps has specific funds and budget execution unto itself that are managed by Marine Corps program sponsors, maintained in a single core integrated Working Capital Fund accounting and budgeting reporting system, and supported by Marine Corps managerial accountants and the Defense Finance and Accounting Service-Kansas City. Given this fiduciary responsibility, the Marine Corps is able to fully comply with Statement of Federal Financial Accounting Concepts Number 2, Entity and Display.

Principal Statements

The FY 2006 Marine Corps Working Capital Fund Principal Statements and related notes are subsidiary financial statements and related notes of the Navy Working Capital Fund, and are presented in the format prescribed by the Department of Defense Financial Management Regulation 7000.14, Volume 6B. The statements and related notes summarize the financial information for individual activity groups and activities within the Marine Corps Working Capital Fund for the fiscal year ending September 30, 2006.

The following statements comprise the Marine Corps Working Capital Fund Principal Statements:

- Consolidated Balance Sheet
- Consolidated Statement of Net Cost
- Consolidated Statement of Changes in Net Position
- Combined Statement Budgetary Resources
- Combined Statement of Financing

The Principal Statements and related notes have been prepared to report financial position pursuant to the requirements of the Chief Financial Officers Act of 1990, as amended by the Government Management Reform Act of 1994. The accompanying notes should be considered an integral part of the Principal Statements.

Department of Defense

Navy Working Capital Fund - Marine Corps

CONSOLIDATED BALANCE SHEET

As of September 30, 2006 and 2005

(\$ in thousands)

	2006 Consolidated	2005 Consolidated
ASSETS (Note 2)		
Intragovernmental:		
Fund Balance with Treasury (Note 3)		
Entity	\$ 30,193	\$ 62,510
Non-entity Seized Iraqi Cash	0	0
Non-entity - Other	0	0
Investments (Note 4)	0	0
Accounts Receivable (Note 5)	33,906	17,144
Other Assets (Note 6)	0	70
Total Intragovernmental Assets	\$ 64,099	\$ 79,724
Cash and Other Monetary Assets (Note 7)	0	0
Accounts Receivable, net (Note 5)	327	199
Loans Receivable (Note 8)	0	0
Inventory and Related Property, net (Note 9)	558,068	636,951
General Property, Plant and Equipment, net (Note 10)	48,275	50,524
Investments (Note 4)	0	0
Other Assets (Note 6)	519	(416)
TOTAL ASSETS	\$ 671,288	\$ 766,982
LIABILITIES (Note 11)		
Intragovernmental:		
Accounts Payable (Note 12)	\$ 6,382	\$ 41,637
Debt (Note 13)	0	0
Other Liabilities (Note 15 & Note 16)	917	18,222
Total Intragovernmental Liabilities	\$ 7,299	\$ 59,859
Accounts Payable (Note 12)	67,846	30,947
Military Retirement Benefits and Other Employment-Related Actuarial Liabilities (Note 17)	29,595	26,667
Environmental Disposal Liabilities (Note 14)	0	0
Loan Guarantee Liability (Note 8)	0	0
Other Liabilities (Note 15 and Note 16)	30,673	13,819
TOTAL LIABILITIES	\$ 135,413	\$ 131,292
NET POSITION		
Unexpended Appropriations - Earmarked Funds (Note 23)	\$ 0	\$ 0
Unexpended Appropriations - Other Funds	0	0
Cumulative Results of Operations - Earmarked Funds	0	0
Cumulative Results of Operations - Other Funds	535,875	635,690
TOTAL NET POSITION	\$ 535,875	\$ 635,690
TOTAL LIABILITIES AND NET POSITION	\$ 671,288	\$ 766,982

The accompanying notes are an integral part of these statements.

Department of Defense

Navy Working Capital Fund - Marine Corps

CONSOLIDATED STATEMENT OF NET COST

For the Years Ended September 30, 2006 and 2005

(\$ in thousands)

	<u>2006 Consolidated</u>	<u>2005 Consolidated</u>
Program Costs		
Gross Costs	\$ 730,863	\$ 659,655
(Less: Earned Revenue)	(708,962)	(683,205)
Net Program Costs	<u>\$ 21,901</u>	<u>\$ (23,550)</u>
Costs Not Assigned to Programs	0	0
(Less: Earned Revenue Not Attributable to Programs)	0	0
Net Cost of Operations	<u><u>\$ 21,901</u></u>	<u><u>\$ (23,550)</u></u>

The accompanying notes are an integral part of these statements.

Department of Defense

Navy Working Capital Fund - Marine Corps

CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION

For the Years Ended September 30, 2006 and 2005

(\$ in thousands)

	<u>2006 Consolidated</u>	<u>2005 Consolidated</u>
CUMULATIVE RESULTS OF OPERATIONS		
Beginning Balances	\$ 635,690	\$ 623,953
Prior period adjustments (+/-)		
Changes in Accounting Principles (+/-)	0	0
Correction of errors (+/-)	0	0
Beginning balances, as adjusted	\$ 635,690	\$ 623,953
Budgetary Financing Sources:		
Appropriations received	\$ 0	\$ 0
Appropriations transferred in/out (+/-)	0	0
Other adjustments (rescissions, etc) (+/-)	0	0
Appropriations used	0	0
Nonexchange revenue	0	0
Donations and forfeitures of cash and cash equivalents	0	0
Transfers in/out without reimbursement (+/-)	0	0
Other budgetary financing sources (+/-)	0	0
Other Financing Sources:		
Donations and forfeitures of property	0	0
Transfers in/out without reimbursement (+/-)	(90,240)	(21,892)
Imputed financing from costs absorbed by others	12,327	10,079
Other (+/-)	0	0
Total Financing Sources	\$ (77,913)	\$ (11,813)
Net Cost of Operations (+/-)	21,901	(23,550)
Net Change	(99,814)	11,737
Ending Balances	\$ 535,876	\$ 635,690
UNEXPENDED APPROPRIATIONS		
Beginning Balances	\$ 0	\$ 0
Prior period adjustments:		
Changes in Accounting Principles (+/-)	0	0
Correction of errors (+/-)	0	0
Beginning balances, as adjusted	\$ 0	\$ 0
Budgetary Financing Sources:		
Appropriations received	\$ 0	\$ 0
Appropriations transferred in/out (+/-)	0	0
Other adjustments (rescissions, etc) (+/-)	0	0
Appropriations used	0	0
Nonexchange revenue	0	0
Donations and forfeitures of cash and cash equivalents	0	0
Transfers in/out without reimbursement (+/-)	0	0
Other budgetary financing sources (+/-)	0	0
Other Financing Sources:		
Donations and forfeitures of property	0	0
Transfers in/out without reimbursement (+/-)	0	0
Imputed financing from costs absorbed by others	0	0
Other (+/-)	0	0
Total Financing Sources	\$ 0	\$ 0
Net Cost of Operations (+/-)	0	0
Net Change	0	0
Ending Balances	\$ 0	\$ 0

The accompanying notes are an integral part of these statements.

Department of Defense

Navy Working Capital Fund - Marine Corps

COMBINED STATEMENT OF BUDGETARY RESOURCES

For the Years Ended September 30, 2006 and 2005

(\$ in thousands)

	<u>2006 Combined</u>	<u>2005 Combined</u>
BUDGETARY FINANCING ACCOUNTS		
Budgetary Resources:		
Unobligated balance, brought forward, October 1	\$ 227,700	\$ 148,373
Recoveries of prior year unpaid obligations	0	0
Budget Authority:		
Appropriations received	0	0
Borrowing authority	0	0
Contract authority	16,540	22,582
Spending authority from offsetting collections:		
Earned		
Collected	621,225	685,552
Change in receivables from Federal sources	17,585	(4,900)
Change in unfilled customer orders		
Advances received	(110)	(472)
Without advance from Federal sources	(11,164)	67,559
Anticipated for the rest of year, without advances	0	0
Previously unavailable	0	0
Expenditure transfers from trust funds	0	0
Subtotal	\$ 644,076	\$ 770,321
Nonexpenditure transfers, net, anticipated and actual	0	0
Temporarily not available pursuant to Public Law	0	0
Permanently not available	0	0
Total Budgetary Resources	\$ 871,776	\$ 918,694
Status of Budgetary Resources:		
Obligations incurred:		
Direct	\$ 0	\$ 0
Reimbursable	694,405	690,994
Subtotal	\$ 694,405	\$ 690,994
Unobligated balance:		
Apportioned	\$ 177,371	\$ 227,700
Exempt from apportionment	0	0
Subtotal	177,371	227,700
Unobligated balances not available	0	0
Total status of budgetary resources	\$ 871,776	\$ 918,694

The accompanying notes are an integral part of these statements.

Department of Defense

Navy Working Capital Fund - Marine Corps

COMBINED STATEMENT OF BUDGETARY RESOURCES

For the Years Ended September 30, 2006 and 2005

(\$ in thousands)

	<u>2006 Combined</u>	<u>2005 Combined</u>
RELATIONSHIP OF OBLIGATIONS TO OUTLAYS		
Change in Obligated Balance:		
Obligated balance, net		
Unpaid obligations, brought forward, October 1	\$ 292,725	\$ 262,375
Less: Uncollected customer payments from	<u>(333,650)</u>	<u>(270,891)</u>
Federal sources, brought forward, October 1		
Total Unpaid obligated balance	<u>(40,925)</u>	<u>(8,516)</u>
Obligations incurred, net (+/-)	\$ 694,405	\$ 690,994
Less: Gross outlays	<u>(653,431)</u>	<u>(660,643)</u>
Obligated balance transferred, net		
Actual transfers, unpaid obligations (+/-)	0	0
Actual transfers, uncollected customer	<u>0</u>	<u>0</u>
payments from Federal sources (+/-)		
Total Unpaid obligated balance transferred, net	<u>0</u>	<u>0</u>
Less: Recoveries of prior year unpaid obligations, actual	0	0
Change in uncollected customer	<u>(6,421)</u>	<u>(62,659)</u>
payments from Federal sources (+/-)		
Obligated balance, net, end of period		
Unpaid obligations	333,699	292,725
Less: Uncollected customer payments from	<u>(340,071)</u>	<u>(333,550)</u>
Federal sources		
Total Unpaid obligated balance, net, end of period	<u><u>(6,372)</u></u>	<u><u>(40,825)</u></u>
Net Outlays:		
Net Outlays:		
Gross Outlays	653,431	660,643
Less: Offsetting collections	<u>(621,115)</u>	<u>(685,079)</u>
Less: Distributed Offsetting receipts	0	0
Net Outlays	<u><u>\$ 32,316</u></u>	<u><u>\$ (24,436)</u></u>

The accompanying notes are an integral part of these statements.

Department of Defense

Navy Working Capital Fund - Marine Corps

CONSOLIDATED STATEMENT OF FINANCING

For the Years Ended September 30, 2006 and 2005

(\$ in thousands)

	2006 Consolidated	2005 Consolidated
Resources Used to Finance Activities:		
Budgetary Resources Obligated		
Obligations incurred	\$ 694,405	\$ 690,994
Less: Spending authority from offsetting collections and recoveries (-)	(627,536)	(747,738)
Obligations net of offsetting collections and recoveries	66,869	(56,744)
Less: Offsetting receipts (-)	0	0
Net obligations	66,869	(56,744)
Other Resources		
Donations and forfeitures of property	0	0
Transfers in/out without reimbursement (+/-)	(90,240)	(21,892)
Imputed financing from costs absorbed by others	12,327	10,079
Other (+/-)	0	0
Net other resources used to finance activities	(77,913)	(11,813)
Total resources used to finance activities	\$ (11,044)	\$ (68,557)
Resources Used to Finance Items not Part of the Net Cost of Operations:		
Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided		
Undelivered orders (-)	\$ (27,627)	\$ (5,175)
Unfilled Customer Orders	(11,274)	67,088
Resources that fund expenses recognized in prior periods	0	0
Budgetary offsetting collections and receipts that do not affect Net Cost of Operations	0	0
Resources that finance the acquisition of assets	(177,220)	(193,226)
Other resources or adjustments to net obligated resources that do not affect Net Cost of Operations		
Less: Trust or Special Fund Receipts related to exchange in the entity's budget (-)	0	0
Other (+/-)	90,240	21,892
Total resources used to finance items not part of the Net Cost of Operations	\$ (125,881)	\$ (109,421)
Total resources used to finance the Net Cost of Operations	\$ (136,925)	\$ (177,978)

The accompanying notes are an integral part of these statements.

Department of Defense

Navy Working Capital Fund - Marine Corps

CONSOLIDATED STATEMENT OF FINANCING

For the Years Ended September 30, 2006 and 2005

(\$ in thousands)

	<u>2006 Consolidated</u>	<u>2005 Consolidated</u>
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:		
Components Requiring or Generating Resources in Future Period:		
Increase in annual leave liability	\$ 0	\$ 0
Increase in environmental and disposal liability	0	0
Upward/Downward reestimates of credit subsidy expense (+/-)	0	0
Increase in exchange revenue receivable from the public (-)	0	0
Other (+/-)	2,928	4,302
Total components of Net Cost of Operations that will require or generate resources in future periods	\$ 2,928	\$ 4,302
Components not Requiring or Generating Resources:		
Depreciation and amortization	\$ 3,560	\$ 3,509
Revaluation of assets and liabilities (+/-)	(38,835)	41,690
Other (+/-)		
Trust Fund Exchange Revenue	0	0
Cost of Goods Sold	191,173	104,921
Operating Materials & Supplies Used	0	0
Other	0	7
Total components of Net Cost of Operations that will not require or generate resources	\$ 155,898	\$ 150,127
Total components of Net Cost of Operations that will not require or generate resources in the current period	\$ 158,826	\$ 154,429
Net Cost of Operations	\$ 21,901	\$ (23,549)

The accompanying notes are an integral part of these statements.

Department of the Navy Subsidiary Financial Statements

Navy Working Capital Fund – Marine Corps
Notes to the Principal Statements

2006



Note 1. Significant Accounting Policies

1.A. Basis of Presentation

These financial statements have been prepared to report the financial position and results of operations of the Navy Working Capital Fund, Marine Corps (NWCF, MC), as required by the “Chief Financial Officers (CFO) Act of 1990,” expanded by the “Government Management Reform Act of 1994,” and other appropriate legislation. The financial statements have been prepared from the books and records of NWCF, MC in accordance with the “Department of Defense Financial Management Regulation,” the Office of Management and Budget Circular (OMB) A-136, Financial Reporting Requirements, and to the extent possible Generally Accepted Accounting Principles (GAAP). The accompanying financial statements account for all resources for which NWCF, MC is responsible. Information relative to classified assets, programs, and operations is excluded from the statements or otherwise aggregated and reported in such a manner that it is not discernable.

The NWCF, MC is unable to fully implement all elements of GAAP and the OMB Circular A-136, due to limitations of its financial management processes and systems and nonfinancial systems and processes that feed into the financial statements. The NWCF, MC derives its reported values and information for major asset and liability categories, largely from nonfinancial systems, such as inventory systems and logistic systems. These systems were designed to support reporting requirements for maintaining accountability over assets and reporting the status of Federal appropriations rather than preparing financial statements in accordance with GAAP. The NWCF, MC continues to implement processes and system improvements addressing these limitations. The NWCF, MC currently has eleven auditor identified financial statement weaknesses:

(1) Financial Management Systems, (2) Intragovernmental Eliminations, (3) Accounting Entries, (4) Fund Balance with Treasury, (5) Environmental Liabilities, (6) General Property, Plant and Equipment, (7) Government Property and Material in Possession of Contractors, (8) Inventory, (9) Operating Materials and Supplies, (10) Statement of Net Cost, and (11) Statement of Financing.

1.B. Mission of the Reporting Entity

The United States Marine Corps (USMC) was created on November 10, 1775, as an act of the 2nd Continental Congress. The overall mission of USMC is to defend advanced naval bases and to conduct such land operations as may be essential to the prosecution of a naval campaign. The NWCF, MC provides goods and quality products and responsive maintenance support services required to support mobilization, surge and reconstitution requirements to DON, and other Department of Defense (DoD), customers to ensure the operating forces are equipped for war in accordance with mobilization plans. In addition, NWCF, MC supports other government and nongovernmental customers.

The NWCF, MC has prepared annual financial statements pursuant to CFO Act of 1990, as amended for the past fourteen years. The Act requires that financial statements be prepared and audited for each revolving fund and account that performed substantial commercial functions, such as those performed by NWCF, MC.

1.C. Appropriations and Funds

The United States Marine Corps (USMC) receives its appropriations and funds as general, working capital (revolving funds), trust, special, and deposit funds. The components use these appropriations and funds to execute their missions and report on resource usage.

The NWCF, MC receive their initial funding through an appropriation or a transfer of resources from existing appropriations or funds and use those capital resources to finance the initial startup. The Working Capital Fund entities provide goods and services on a reimbursable basis. Reimbursable

receipts fund ongoing operations and are generally available in their entirety for use without further congressional action.

1.D. Basis of Accounting

For Fiscal Year (FY) 2006, NWCF, MC financial management systems are unable to meet all of the requirements for full accrual accounting. Many of NWCF, MC's financial and nonfinancial feeder systems and processes were designed and implemented prior to the issuance of GAAP for federal agencies. These systems were not designed to collect and record financial information on the full accrual accounting basis as required by GAAP. Most of NWCF, MC's legacy systems were designed to record information on a budgetary basis.

The DoD has undertaken efforts to determine the actions required to bring its financial and nonfinancial feeder systems and processes into compliance with GAAP. One such action is the current revision of its accounting systems to record transactions based on the United States Standard General Ledger (USSGL). Until all of NWCF, MC's financial and nonfinancial feeder systems and processes are updated to collect and report financial information as required by GAAP, NWCF, MC financial data will be based on budgetary transactions (obligations, disbursements, and collections), transactions from nonfinancial feeder systems, and adjustments for known accruals of major items such as payroll expenses, accounts payable, and environmental liabilities.

In addition, DoD identifies program costs based upon the major appropriation groups provided by the Congress. Current processes and systems do not capture and report accumulated costs for major programs based upon the performance measures as required by the Government and Performance and Results Act (GPRA). The DoD is in the process of reviewing available data and attempting to develop a cost reporting methodology that balances the need for cost information required by the Statement of Federal Financial Accounting Standards (SFFAS) No. 4, "Managerial Cost Accounting Concepts and Standards for the Federal Government," with the need to keep the financial statements from being overly voluminous.

1.E. Revenues and Other Financing Sources

Depot Maintenance activities recognize revenue according to the percentage of completion method. Supply Management activities recognize revenue from the sale of inventory items.

The NWCF, MC does not include nonmonetary support provided by US allies for common defense and mutual security in its list of other financing sources that appears in the Statement of Net Cost and the Statement of Financing. The US has agreements with foreign countries that include either direct or indirect sharing of costs that each country incurs in support of the same general purpose. Examples include countries where there is a mutual or reciprocal defense agreement, where US troops are stationed, or where US fleets are in a port.

1.F. Recognition of Expenses

For financial reporting purposes, DoD policy requires the recognition of operating expenses in the period incurred. However, because NWCF, MC's financial and nonfinancial feeder systems were not designed to collect and record financial information on the full accrual accounting basis, accrual adjustments are made for major items such as payroll expenses, accounts payable, environmental liabilities, and unbilled revenue. The NWCF, MC's expenditures for capital and other long-term assets are recognized as operating expenses based on depreciation. In the case of operating materials and supplies (OM&S), operating expenses are generally recognized when the items are purchased. Efforts are underway to migrate towards the consumption method for recognizing OM&S expenses.

1.G. Accounting for Intragovernmental Activities

Preparation of reliable financial statements requires the elimination of transactions occurring among entities within DoD or between two or more federal agencies. However, NWCF, MC cannot accurately identify most of its intragovernmental transactions by customer because NWCF, MC's systems do not track buyer and seller data needed to match related transactions.

Seller entities within DoD provided summary seller-side balances for revenue, accounts receivable, and unearned revenue to the buyer-side internal DoD accounting offices.

In most cases, the buyer-side records are adjusted to agree with DoD seller-side balances. IntraDoD intragovernmental balances are then eliminated. Starting in FY 2005, NWCF, MC properly eliminates the revenue results from intraDoD sales of capitalized assets. The DoD is developing long-term system improvements that will include sufficient up-front edits and controls to eliminate the need for after-the-fact reconciliations. The volume of intragovernmental transactions is so large that after-the-fact reconciliation cannot be accomplished effectively with existing or foreseeable resources.

The Department of the Treasury Financial Management Service (FMS), is responsible for eliminating transactions between DoD and other federal agencies. The Treasury Financial Manual, Part 2 – Chapter 4700, "Agency Reporting Requirements for the Financial Report of the United States Government" and the Treasury's "Federal Intragovernmental Transactions Accounting Policy Guide," provide guidance for reporting and reconciling intragovernmental balances. While NWCF, MC is unable to fully reconcile intragovernmental transactions with all federal partners, NWCF, MC is able to reconcile balances pertaining to investments in federal securities, borrowings from the U.S. Treasury and the Federal Financing Bank, Federal Employees' Compensation Act transactions with the Department of Labor (DOL), and benefit program transactions with the Office of Personnel Management (OPM). The DoD's proportionate share of public debt and related expenses of the federal government are not included. The Federal Government does not apportion debt and its related costs to federal agencies. The DoD's financial statements, therefore, do not report any portion of the public debt or interest thereon, nor do the statements report the source of public financing whether from issuance of debt or tax revenues.

Financing for the construction of DoD facilities is obtained through appropriations. To the extent this financing ultimately may have been obtained through the issuance of public debt, interest costs have not been capitalized since the Department of the Treasury does not allocate such interest costs to the benefiting agencies.

1.H. Transactions with Foreign Governments and International Organizations

Each year, NWCF, MC sells defense articles and services to foreign governments and international organizations under the provisions of the "Arms Export Control Act of 1976." Under the provisions of the Act, DoD has authority to sell defense articles and services to foreign countries and international organizations generally at no profit or loss to US Government. Payment is required in advance.

1.I. Funds with the U.S. Treasury

The NWCF, MC's monetary financial resources are maintained in U.S. Treasury accounts. The disbursing offices of the Defense Finance and Accounting Service (DFAS), the Military Services, the U.S. Army Corps of Engineers (USACE) and the Department of State's financial service centers process the majority of NWCF, MC cash collections, disbursements, and adjustments worldwide. Each disbursing station prepares monthly reports that provide information to the U.S. Treasury on check issues, electronic fund transfers, interagency transfers, and deposits.

In addition, DFAS sites and USACE Finance Center submit reports to the Department of the Treasury, by appropriation, on interagency transfers, collections received, and disbursements issued. The Department of the Treasury records this information to the applicable fund balance with treasury (FBWT) account. Differences in NWCF, MC recorded balance in FBWT accounts and Treasury's FBWT accounts sometimes result and are subsequently reconciled.

1.J. Foreign Currency

Not Applicable.

1.K. Accounts Receivable

As presented in the Balance Sheet, accounts receivable includes accounts, claims, and refunds receivable from other federal entities or from the public. Allowances for uncollectible accounts due from the public are based upon analysis of collection experience by fund type. The DoD does not recognize an allowance for estimated uncollectible amounts from other federal agencies. Claims against other federal agencies are to be resolved between the agencies (per Code of Federal Regulations 4CFR 101).

DoD Components use a variety of techniques for estimating the allowance for uncollectible accounts receivable from the public. The NWCF, MC bases the estimate of uncollectible accounts receivable on a percentage of the total that was billed after the total project cost has been adjusted to reflect the advance deposit. The NWCF, MC requires an advance deposit from all public entities prior to the commencement of work. Therefore, an assumption is made that the amount of uncollectible accounts should be negligible.

1.L. Direct Loans and Loan Guarantees

Not Applicable.

1.M. Inventories and Related Property

Most of NWCF, MC inventories are currently reported at an approximate historical cost using Latest Acquisition Cost (LAC) adjusted for holding gains and losses. The remaining inventory is valued at Moving (Weighted) Average Cost (MAC). The LAC method is used because legacy inventory systems were designed for material management rather than accounting. Although these systems provide visibility and accountability over inventory items, they do not maintain historical cost data necessary to comply with the SFFAS No. 3, "Accounting for Inventory and Related Property." Additionally, these systems cannot produce financial transactions using USSGL, as required by the Federal Financial Management Improvement Act of 1996 (P.L. 104-208). The NWCF, MC plans to utilize new systems development processes to transition the inventory to the moving average cost method.

SFFAS No. 3 requires separate accounting for "inventory held for sale" and "inventory held in reserve for future sale." The NWCF, MC manages only military or government specific materiel under normal conditions. Therefore, there is no management or valuation difference between the two USSGL accounts. Items commonly used in and available from the commercial sector are not managed in NWCF, MC material management activities.

Related property includes operating materials and supplies (OM&S) and stockpile materials. The OM&S, including munitions not held for sale, are valued at standard purchase price. The DoD uses both the consumption method and the purchase method of accounting for OM&S. Items that are centrally managed and stored, such as ammunition and engines, are generally recorded using the consumption method and are reported on the Balance Sheet as OM&S. When current systems cannot fully support the consumption method, NWCF, MC uses the purchase method. Under this method, materials and supplies are expensed when purchased. During FY 2006, NWCF, MC expensed significant amounts using the purchase method because the systems could not support the consumption method or management deemed that the item was in the hands of the end user.

The NWCF, MC recognizes condemned material as "Excess, Obsolete, and Unserviceable." The cost of disposal is greater than the potential scrap value; therefore, the net value of condemned material is zero. Potentially redistributed material, presented in previous years as "Excess, Obsolete, and Unserviceable," is included in the "Held for Use" or "Held for Repair" categories according to its condition.

Past audits identified uncertainties about completeness and existence of reported values of inventory. Inventory available and purchased for resale includes consumable spares, repair parts, and repairable items owned and managed by NWCF, MC. This inventory is retained to support military or national contingencies. Inventory held for repair is damaged inventory that requires repair to make suitable for sale. It is more economical to repair than to procure these inventory items. Because NWCF, MC often relies on weapon systems and machinery no longer in production, NWCF, MC supports a process that encourages the repair and rebuilding of certain items. This repair cycle is essential to maintaining a ready, mobile, and armed military force. Work in process balances include costs related to the production or servicing of items, including direct material, direct labor, applied overhead and other direct costs. Work in process also includes the value of finished products or completed services pending the submission of bills to the customer. The work in process designation may also be used to accumulate the amount paid to a contractor under cost reimbursable contracts, including amounts withheld from payment to ensure performance, and amounts paid to other government plants for accrued costs of end items of material ordered but not delivered. Work in process includes munitions in production and depot maintenance work with its associated labor, applied overhead, and supplies used in the delivery of maintenance services.

1.N. Investments in U.S. Treasury Securities

Not Applicable.

1.O. General Property, Plant and Equipment

The DoD is moving away from a standard capitalization threshold for all categories (e.g. real property, military equipment, etc.) of General Property Plant and Equipment (PP&E) to one that is specific for each individual category.

The capitalization threshold was revised from \$100,000 to \$20,000 for real property. The current \$100,000 capitalization threshold remains unchanged for the remaining General PP&E categories. Although, DoD revised the capitalization threshold from \$100,000 to \$20,000 for real property, USMC capitalization threshold for real property currently remains \$100,000, except for Minor Construction threshold for NWCF, which is at \$20,000.

General Property, Plant and Equipment (PP&E) assets are capitalized at historical acquisition cost plus capitalized improvements when an asset has a useful life of two or more years and the acquisition cost equals or exceeds DoD capitalization threshold of \$100,000. The DoD also requires capitalization of improvement costs over the DoD capitalization threshold of \$100,000 for General PP&E. The DoD depreciates all General PP&E, other than land, on a straight-line basis.

Prior to FY 1996, General PP&E was capitalized if it had an acquisition cost of \$15,000, \$25,000, and \$50,000 for fiscal years 1993, 1994, and 1995, respectively, and an estimated useful life of two or more years. General PP&E previously capitalized at amounts below \$100,000 were written off General Fund financial statements in FY 1998. No adjustment was made for NWCF, MC assets. These assets remain capitalized and reported on NWCF, MC financial statements.

The SFFAS No. 23, "Eliminating the Category National Defense Property, Plant, and Equipment," establishes generally accepted accounting principles for valuing and reporting military equipment (e.g., ships, aircraft, combat vehicles, weapons) in federal financial statements. The Standard provided for the use of estimated historical cost for valuing military equipment if obtaining actual historical cost information is not practical. The DoD used Bureau of Economic Analysis (BEA) to calculate the value of the military equipment for reporting periods from October 1, 2002 through March 31, 2006.

Effective with 3rd Quarter, FY 2006, the DDoD replaced the BEA estimation methodology with an estimation methodology for military equipment based on DoD internal records. The DoD initially

identified the universe of military equipment by accumulating information relating to program funding and associated military equipment, equipment useful life, program acquisitions and disposals to create a baseline. The military equipment baseline is updated using expenditure information, and information related to acquisition and disposals.

1.P. Advances and Prepayments

The NWCF, MC records payments in advance of the receipt of goods and services as advances or prepayments and reports them as assets on the Balance Sheet. The NWCF, MC recognizes advances and prepayments as expenses when it receives the related goods and services.

1.Q. Leases

Not Applicable.

1.R. Other Assets

The NWCF, MC conducts business with commercial contractors under two primary types of contracts: fixed price and cost reimbursable. To alleviate the potential financial burden on the contractor that long-term contracts can cause, NWCF, MC provides financing payments.

Other assets include those assets, such as military and civil service employee pay advances, travel advances, and contract financing payments, that are not reported elsewhere on the Balance Sheet.

Contract financing payments are defined in the Federal Acquisition Regulations (FAR), Part 32, as authorized disbursements of monies to a contractor prior to acceptance of supplies or services by the Government. These payments are designed to alleviate the potential financial burden on contractors performing on certain long-term contracts and facilitate competition for defense contracts. Contract financing payments clauses are incorporated in the contract terms and conditions and may include advance payments, performance-based payments, commercial advance and interim payments, progress payments based on cost, and interim payments under certain cost-reimbursement contracts. Contract financing payments do not include invoice payments, payments for partial deliveries, lease and rental payments, or progress payments based on a percentage or stage of completion, which the Defense Federal Acquisitions Regulations Supplement (DFARS) authorizes only for construction of real property, shipbuilding, and ship conversion, alteration, or repair.

1.S. Contingencies and Other Liabilities

The SFFAS No. 5, "Accounting for Liabilities of the Federal Government," as amended by SFFAS No. 12, "Recognition of Contingent Liabilities Arising from Litigation," defines a contingency as an existing condition, situation, or set of circumstances that involves an uncertainty as to possible gain or loss. The uncertainty will be resolved when one or more future events occur or fail to occur. The NWCF, MC recognizes contingent liabilities when past events or exchange transactions occur, a future loss is probable, and the loss amount can be reasonably estimated.

Financial statement reporting is limited to disclosure when conditions for liability recognition do not exist but there is at least a reasonable possibility of incurring a loss or additional losses. Examples of loss contingencies include the collectibility of receivables, pending or threatened litigation, and possible claims and assessments. The NWCF, MC loss contingencies arise as a result of pending or threatened litigation or claims and assessments occur due to events such as aircraft, ship and vehicle accidents, medical malpractice, property or environmental damages, and contract disputes. Such amounts are developed in conjunction with, and not easily identifiable separately from, environmental disposal costs.

1.T. Accrued Leave

The NWCF, MC reports as liabilities military leave and civilian earned leave except sick leave that has been accrued and not used as of the Balance Sheet date. Sick leave is expensed as taken. The liability reported at the end of the accounting period reflects the current pay rates.

1.U. Net Position

Net Position consists of unexpended appropriations and cumulative results of operations (CRO). Unexpended appropriations represent the amounts of authority that are unobligated and have not been rescinded or withdrawn. Unexpended appropriations also represent amounts obligated for which legal liabilities for payments have not been incurred.

The CRO represents the net difference, since inception of an activity, between expenses and losses and financing sources (including appropriations, revenue, and gains). Beginning, with FY 1998, the cumulative results also include donations and transfer in and out of assets without reimbursement.

1.V. Treaties for Use of Foreign Bases

Not Applicable.

1.W. Comparative Data

Financial statement fluctuations greater than two percent of total assets on the Balance Sheet or ten percent from the previous period presented are explained within the notes to the financial statements.

1.X. Unexpended Obligations

The NWCF, MC obligates funds to provide goods and services for outstanding orders not yet delivered. The financial statements do not reflect this liability for payment for goods and services not yet delivered.

1.Y. Undistributed Disbursements and Collections

Undistributed disbursements and collections represent the difference between disbursements and collections matched at the transaction level to a specific obligation, payable, or receivable in the activity field records as opposed to those reported by the U.S. Treasury. These amounts should agree with the undistributed amounts reported on the departmental accounting reports. In-transit payments are those payments that have been made to other agencies or entities that have not been recorded in their accounting records. These payments are applied to the entities' outstanding accounts payable balance. In-transit collections are those collections from other agencies or entities that have not been recorded in the accounting records. These collections are also applied to the entities' accounts receivable balance.

The DoD policy is to allocate supported undistributed disbursements and collections between federal and nonfederal categories based on the percentage of federal and nonfederal accounts payable and accounts receivable. Unsupported undistributed disbursements are recorded in accounts payable. Unsupported undistributed collections are recorded in other liabilities. The NWCF, MC does not follow this procedure. Collections are allocated to federal accounts receivable and disbursements to nonfederal accounts payable.

Note 2. Nonentity Assets

As of September 30	2006	2005
<i>(Amounts in thousands)</i>		
1. Intragovernmental Assets		
A. Fund Balance with Treasury	\$ 0	\$ 0
B. Accounts Receivable	0	0
C. Total Intragovernmental Assets	\$ 0	\$ 0
2. Nonfederal Assets		
A. Cash and Other Monetary Assets	\$ 0	\$ 0
B. Accounts Receivable	0	0
C. Other Assets	0	0
D. Total Nonfederal Assets	\$ 0	\$ 0
3. Total Nonentity Assets	\$ 0	\$ 0
4. Total Entity Assets	\$ 671,288	\$ 766,982
5. Total Assets	\$ 671,288	\$ 766,982

6. Information Related to Nonentity and Entity Assets

Fluctuations and Abnormalities

The Navy Working Capital Fund, Marine Corps (NWCF, MC) does not have nonentity assets.

Composition of Nonentity Assets

Not Applicable.

Other Disclosures Related to Nonentity Assets

No disclosures required.

Note 3. Fund Balance with Treasury

As of September 30	2006	2005
<i>(Amounts in thousands)</i>		
1. Fund Balances		
A. Appropriated Funds	\$ 0	\$ 0
B. Revolving Funds	30,193	62,510
C. Trust Funds	0	0
D. Special Funds	0	0
E. Other Fund Types	0	0
F. Total Fund Balances	<u>\$ 30,193</u>	<u>\$ 62,510</u>
2. Fund Balances Per Treasury Versus Agency		
A. Fund Balance per Treasury	\$ 30,193	\$ (10,870)
B. Fund Balance per United States Marine Corps (USMC)	30,193	62,510
3. Reconciling Amount	<u>\$ 0</u>	<u>\$ (73,380)</u>

4. Explanation of Reconciliation Amount:

Fund Balance per Treasury, negative \$10.9 million, was incorrectly stated in Fiscal Year (FY) 2005. The correct amount should have been \$62.5 million.

5. Information Related to Fund Balance with Treasury:

Fluctuations and Abnormalities

In FY 2006, fund balance with treasury (FBWT) decreased \$32.3 million 52%, due to a decrease of \$29.1 million for Depot Maintenance and \$3.2 million for Supply Management, as compared to FY 2005. The primary drivers of the decrease in FBWT are explained as follows:

Depot Maintenance Activity Group (DMAG)

The FBWT decreased \$29.1 million in FY 2006, as compared to FY 2005. This is the result of increased disbursements to pay for operating material and supplies, purchased by the Maintenance Centers to support customer workload related to the Global War on Terror (GWOT). The majority of the material was purchased in 1st Quarter, FY 2006, billed and liquidated in 2nd through 4th Quarters, FY 2006. The increase in the material being purchased is due to the severely damaged warfighting weapon systems that require above average repair parts to complete restoration to a ready for issue warfighting condition. In addition, for workload related to the armor plating project, the Maintenance Centers purchased material in bulk due to the following reasons:

- ensure the material was delivered in a timely manner,
- to support the production schedule,
- to take advantage of opportunities for better pricing and,
- to ensure available vendor market from reliable resources

It is anticipated that as the workload is completed and customers are billed, revenue will be earned and fund balance with treasury will increase.

In contrast, DMAG collections were significantly increased during the 4th Quarter, FY 2006. The previously discussed armor project, where customers due to GWOT engagements, required the workload to be completed by the Maintenance Centers on an accelerated rate thus increasing billings to and collection/payment from customers. The accelerated effort increased DMAG activity and led to an increase to FBWT through collections on reimbursable orders.

Supply Management, Marine Corps (SMAG)

FBWT decreased \$3.2 million in FY 2006, as compared to FY 2005. This is a direct result of overall customer orders decreasing due to the following:

During the 3rd Quarter, FY 2005, Twenty Nine Palms Marine Corps Organization awarded a contract to General Services Administration (GSA) to provide vendor owned, vendor managed consumable operational supplies and material to its customers who were previously making purchases via the Direct Support Stock Center (Retail Activity) where NWCF received obligation authority to procure and sell to its customers. Camp Butler Marine Corps Organization awarded the same type of contract in the 1st Quarter, FY 2006. Supply Management WCF considers this a permanent reduction to sales targets.

In addition, FBWT decreased as a result of retail organizations at Albany, Georgia and Barstow, California who procured packing supplies, in 3rd Quarter, FY 2006 to support their customers (Maintenance Centers (DMAG)) in shipping completed workload related to producing armor kits for DMAG customers. The packing supplies were anticipated to be received and sold to DMAG during 4th Quarter, but was not received and sold until October, FY 2007.

Composition of Fund Balance with Treasury

FBWT of \$30.2 million reflects FY 2005 ending balance of \$62.5 million plus current FY 2006 collections, disbursements, and other cash transactions recorded in the Navy Working Capital Fund, Marine Corps (NWCF, MC) Treasury sub-limit 97X4930.002. The following table details the amounts recorded as of September 30, 2006.

(Amounts in thousands)

Collections	\$ 621,115
Disbursements	\$ (653,431)

Intragovernmental Payment and Collection (IPAC)

The IPAC differences are reconcilable differences that represent amounts recorded by Treasury but not reported by the organization. The IPAC differences for the U.S. Marine Corps (USMC) cannot be differentiated between NWCF, MC and General Funds; therefore no IPAC differences are being reported for NWCF, MC. All amounts, if applicable, will be reported on the USMC General Fund statement.

Status of Fund Balance with Treasury

As of September 30	2006	2005
<i>(Amounts in thousands)</i>		
1. Unobligated Balance		
A. Available	\$ 177,371	\$ 227,700
B. Unavailable	0	0
2. Obligated Balance not yet Disbursed	\$ 333,699	\$ 292,725
3. Nonbudgetary FBWT	\$ 0	\$ 0
4. NonFBWT Budgetary Accounts	\$ (1,572,615)	\$ (1,549,554)
5. Total	\$ (1,061,545)	\$ (1,029,129)

Fluctuations and Abnormalities

There are no abnormalities to disclose and no variances equal to or greater than ten percent to explain for FY 2006.

Definitions

The Status of Fund Balance with Treasury consists of unobligated and obligated balances. These balances reflect the budgetary authority remaining for disbursements against current or future obligations. In addition, the Status of Funds Balance with Treasury includes various accounts that affect either budgetary reporting or fund balance with treasury, but not both.

Unobligated Balance represents the cumulative amount of budgetary authority that has not been set aside to cover outstanding obligations. Unobligated Balance is classified as available or unavailable and is associated with appropriations expiring at fiscal year end that remain available only for obligation adjustments until the account is closed.

Obligated Balance not yet Disbursed represents funds that have been obligated for goods that have been received or services that have not been performed.

Non-Budgetary Fund Balance with Treasury (FBWT) includes entity and nonentity Fund Balance with Treasury accounts, which do not have budgetary authority, such as unavailable receipt accounts or clearing accounts.

Non-FBWT Budgetary Accounts include budgetary accounts that do not affect Fund Balance with Treasury, such as contract authority, borrowing authority and investment accounts. This category reduces the Status of Fund Balance with Treasury.

The difference between total fund balance on the FBWT schedule and total of the status of funds schedule is primarily due to the \$1.6 billion nonbudgetary FBWT. This is being addressed by DFAS in which it is believed to be related to Navy's distribution of Contract Authority/Cash sometime around 1995. The Navy is researching this issue. In addition, this difference is cumulative of various problems, as well as, an internal weakness of creating budgetary accounts from proprietary accounts in footnotes. The DFAS is working with Department of Navy (DON) in the Financial Improvement Plan and in the Cash Initiative to standardize cash forecasting methods; standardize cash reconciliation processes; perform a cash rebuild for DON; and, populate budgetary accounts at the field activity level. The accumulation of these

efforts will correct this difference. It is anticipated that the Marine Corps will be provided an explanation of this issue when the review is completed.

Disclosures Related to Suspense/Budget Clearing Accounts

Information Related to Suspense/Budget Clearing Accounts:

NWCF, MC Suspense/Budget Clearing Accounts are being reported under Marine Corps General Funds.

Disclosures Related to Problem Disbursements and In-Transit Disbursements

As of September 30	2004	2005	2006	(Decrease)/ Increase from FY 2005 to 2006
--------------------	------	------	------	---

(Amounts in thousands)

1. Total Problem Disbursements, Absolute Value

A. Unmatched Disbursements (UMDs)	\$	0	\$ 5,719	\$ 4,088	\$ (1,631)
B. Negative Unliquidated Obligations (NULO)		0	0	2	2

2. Total In-transit

Disbursements, Net	\$	0	\$ (6,565)	\$ 6,346	\$ 12,911
--------------------	----	---	------------	----------	-----------

Information Related to Disclosures Related to Problem Disbursements and In-Transit Disbursements

Fluctuations and Abnormalities

In FY 2006, Total Unmatched Disbursements, decreased \$1.6 million, 29%, as compared to FY 2005. This is due to elements of operations and processes, incorporated by the Marine Corps Depots, to work credit card payments for material that was placed on order. Difficulties exist in being able to utilize the current financial management system (Defense Industrial Financial Management System) and the various inventory management systems to identify, at the document level, credit cards as the source of payment. In FY 2004, an interim process was worked out to mitigate this problem. Beginning in late 1st Quarter, FY 2006, due to DFAS problems described above, delays in completing actions outlined to work and clear unmatched disbursements from credit card sources, was experienced. This caused the unmatched disbursement to increase substantially beginning in 2nd Quarter, FY 2006. The level of unmatched disbursements by the end of 4th Quarter, FY 2006 decreased drastically due to the collaborative and concentrated efforts of both the Marine Corps and DFAS.

In FY 2006, Negative Unliquidated Obligations increased \$2.4 thousand, 100%, and In-Transit Disbursements, Net increased \$12.9 million, 195%, as compared to FY 2005. This is due to an intensive analysis performed by DFAS in 1st Quarter, FY 2006 that resulted in the identification of the causes and systems creating increased numbers of undistributed disbursements. The intensive analysis also allowed DFAS to identify the undistributed values by the proper categories such as supported and unsupported, in-transit or problem disbursements and to complete processes necessary to clear the unmatched/undistributed in a timelier manner. In addition, process improvements were implemented to avoid future significant increases in this category.

Unmatched Disbursements (UMDs)

An unmatched disbursement (UMD) occurs when a payment is not matched to a corresponding obligation in the accounting system. Absolute value is the sum of positive values of debit and credit transactions without regard to the sign (plus or minus).

Negative Unliquidated Obligations (NULOs)

A negative unliquidated obligation (NULO) occurs when a payment is made against a valid obligation. However, the payment is greater than the amount of the obligation recorded in the accounting system. These payments have been made using available funds and are based on valid receiving reports for goods and services delivered under valid contracts.

In-transit Disbursements

In-transit disbursements represent the net value of disbursements and collections made by a Department of Defense disbursing activity on behalf of an accountable activity and have not yet been recorded in the accounting system.

Other Disclosures

The NWCF, MC problem disbursements reported have no amounts related to Foreign Military Sales. The problem disbursement and in-transit disbursement metrics furnished to DFAS Arlington included Treasury Index 97 (TI97) appropriations that will not be reported on Marine Corps' financial statements. Amounts will be reported on the appropriate TI97 financial statements.

Note 4. Investments and Related Interest

The Navy Working Capital Fund, Marine Corps (NWCF, MC) does not have investments and related interest.

Note 5. Accounts Receivable

As of September 30	2006			2005
	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable, Net	Accounts Receivable, Net
<i>(Amounts in thousands)</i>				
1. Intragovernmental Receivables	\$ 33,906	N/A	\$ 33,906	\$ 17,144
2. Nonfederal Receivables (From the Public)	\$ 327	\$ 0	\$ 327	\$ 199
3. Total Accounts Receivable	\$ 34,233	\$ 0	\$ 34,233	\$ 17,343

4. Other Information Related to Accounts Receivable:**Fluctuations and Abnormalities**

Intragovernmental accounts receivable increased \$16.8 million, 98%, in Fiscal Year (FY) 2006 as compared to FY 2005. The primary driver of the increase is due to Depot Maintenance Activity Group (DMAG)

receiving and billing additional workload in FY 2006. The DMAG intragovernmental accounts receivable increased \$20.3 million, 204%, due to increased operating tempo resulting from the additional workload completed and revenue billed in order to meet customer required delivery timeframes for repair and return of equipment engaged in the Global War on Terror (GWOT). Although bills processed during FY 2006 were collected in order to relieve the intragovernmental accounts receivable, the majority of the increase occurred in September 2006. Some of the bills to customers that were processed the last week of FY 2006 were not collected to relieve the accounts receivable until 1st Quarter, FY 2007. The additional workload was received from Procurement, Marine Corps, Operation and Maintenance, Marine Corps/ Marine Corps Reserve, and the Army customers. The average revenue bill in FY 2006 increased from \$7.4 million in FY 2005 to \$19.4 million in FY 2006.

Nonfederal accounts receivable increased \$128.3 thousand, 65%, in FY 2006. The primary driver of the increase is attributed to DMAG. Nonfederal accounts receivable increased due to unplanned workload associated with repair and return of Amphibious Assault Vehicles and machine guns owned by foreign military sales customers. This occurred at the end of 3rd Quarter, FY 2006 as a result of the workload being completed and revenue billed. Collections from the billings will not be received until 1st Quarter, FY 2007.

Allowance Method

The Statement of Federal Financial Accounting Standards No. 1, "Accounting for Selected Assets and Liabilities," and Department of Defense (DoD) Financial Management Regulation require that federal agencies establish an allowance for uncollectible accounts receivable nonfederal. This account has been established within Navy Working Capital Fund, Marine Corps (NWCF, MC). This amount is low, as NWCF requires an advance deposit from all nonfederal entities prior to the commencement of work. Therefore, an assumption is made that the amount of uncollectible accounts should be negligible. The allowance amount represents a percentage of the total that was billed after the total project cost has been adjusted to reflect the advance deposit. Based on the assumption of negligible risk of loss for uncollectible accounts, there is no reserve for uncollectible accounts presented in the accompanying financial statements.

Allocation of Undistributed Collections

DoD policy is to allocate supported undistributed collections between federal and nonfederal categories based on the percentage of federal and nonfederal accounts receivable. Unsupported undistributed collections should be recorded in United States Standard General Ledger account 2400, liability for deposit funds, clearing accounts, and undeposited collections. NWCF, MC does not follow this allocation procedure. Collections are allocated to federal accounts receivable. This is required because of the potential that some of the unsupported undistributed collections do not belong to NWCF and will have to be transferred to the appropriate fund holder.

Trading Partner Data

NWCF, MC's accounting systems do not capture specific trading partner data at the transaction level in a manner that facilitates trading partner aggregations. Therefore, NWCF, MC is unable to reconcile intragovernmental accounts receivable balances with most trading partners. Through an ongoing Business Management Modernization Program, DoD intends to develop long-term systems improvements that will capture the data necessary to perform reconciliations. The Department of the Navy (DON) is also working on short-term solutions to gather the required information as outlined in DON Financial Improvement Plan.

Aged Accounts Receivable

As of September 30	2006		2005	
	Intragovernmental	Nonfederal	Intragovernmental	Nonfederal
<i>(Amounts in thousands)</i>				
CATEGORY				
Nondelinquent				
Current	\$ 33,633	\$ 320	\$ 16,968	\$ 193
Noncurrent	0	0	0	0
Delinquent				
1 to 30 days	\$ 9	\$ 0	\$ 2	\$ 0
31 to 60 days	322	(0)	40	2
61 to 90 days	254	0	15	0
91 to 180 days	131	2	91	4
181 days to 1 year	89	2	51	0
Greater than 1 year and less than or equal to 2 years	163	3	0	0
Greater than 2 years and less than or equal to 6 years	0	0	0	0
Greater than 6 years and less than or equal to 10 years	0	0	0	0
Greater than 10 years	0	0	0	0
Subtotal	\$ 34,601	\$ 327	\$ 17,167	\$ 199
Less Supported Undistributed Collections	0	0	(23)	0
Less Eliminations	(695)	0	0	0
Less Other	0	0	0	0
Total	\$ 33,906	\$ 327	\$ 17,144	\$ 199

Current systems do not allow for the identification of the aging of the undistributed amounts. Aging information is not automatically generated and readily available in all feeder financial systems and therefore must be manually reported.

The Monthly Receivables Report is manually maintained by DFAS and NWCF, MC organizations. The bottom portion of this chart is derived from the accounting adjustments required in the preparation of the financial statements. In order to prepare this chart, NWCF, MC must make adjustments to the "other" line on this chart in order to reconcile the two portions. The DFAS is working with the field sites to eliminate the differences between these two areas.

The eliminations line in this chart is the amount of internal NWCF, MC eliminations as reported in the financial statements. The \$695.6 thousand represents the amounts attributable to other NWCF activities.

The amount of delinquent intragovernmental receivables greater than 30 days old totaled is \$958.4 thousand. The amount represents the dollar amount expected from customers, which is generated from the sale of excess material and goods and services.

The amount of nonfederal accounts receivable over 30 days is \$6.8 thousand. The amount represents the dollar amount expected from customers and generated from the sale of goods and services to foreign military sales and nonfederal customers.

DFAS Kansas City and the Marine Corps continue to research and contact bill payers in an effort to resolve the delinquent aged receivables over 30 days.

Nonfederal Refunds Receivable

The total amount of nonfederal refunds receivables does not exceed 10% of the nonfederal accounts receivable, net amount on the Balance Sheet.

Other Disclosures Related to Accounts Receivable

No further disclosures required.

Note 6. Other Assets

As of September 30	2006	2005
<i>(Amounts in thousands)</i>		
1. Intragovernmental Other Assets		
A. Advances and Prepayments	\$ 0	\$ 70
B. Other Assets	0	0
C. Total Intragovernmental Other Assets	\$ 0	\$ 70
2. Nonfederal Other Assets		
A. Outstanding Contract Financing Payments	\$ 501	\$ 0
B. Other Assets (With the Public)	18	(416)
C. Total Nonfederal Other Assets	\$ 519	\$ (416)
3. Total Other Assets	\$ 519	\$ (346)

Fluctuations and Abnormalities

Intragovernmental Other Assets, Advances and Prepayments decreased \$70.4 thousand, 100%, in FY 2006. During 4th Quarter, FY 2005, \$70.4 thousand in travel advances supporting Depot Maintenance Activity Group (DMAG) civilian employees were erroneously posted as intragovernmental other assets. These costs were reclassified and correctly posted as nonfederal other assets with the public beginning in the 1st Quarter, FY 2006 reducing intragovernmental assets to zero. The error was identified as a result of functions required to separate U.S. Marine Corps (USMC) financial records from the Navy beginning in the 1st Quarter, FY 2006.

Total Nonfederal Other Assets increased \$935.4 thousand, 225%, in 4th Quarter, FY 2006 as compared to FY 2005. The primary driver for this increase is Supply Management Activity Group (SMAG). SMAG increased \$917.4 thousand. During FY 2005, \$416.2 thousand for expected material returns from the sale of excess material was erroneously recorded as nonfederal other assets. As a result of a review

of accounts conducted by Defense Finance and Accounting Service and USMC during 1st Quarter, FY 2006 a posting error was identified and corrected, decreasing nonfederal other assets and reclassified as an increase to refund receivables. Due to a manual process implemented to correctly identify material credits, the refund receivable was not cleared until 2nd Quarter, FY 2006. Also in September 2006, \$501.2 thousand was recorded for anticipated future contract financing payments.

Composition of Other Assets (With the Public)

Other Assets (With the Public) includes amounts paid to DMAG civilian employees for the reimbursement of meals, incidental expenses, mileage, and other expenses while in and official government travel status. Other assets with the public also include all authorized expenses related to expenses incurred by employees to relocate from one duty station to another.

Other Disclosures

Contract terms and conditions for certain types of contract financing payments convey certain rights to the Department of Defense (DoD) that protect the contract work from state or local taxation, liens or attachment by the contractor's creditors, transfer of property, or disposition in bankruptcy; however, these rights should not be misconstrued to mean that ownership of the contractor's work has transferred to the Government. The government does not have the right to take work, except as provided in contract clauses related to termination or acceptance, and DoD is not obligated to make payment to the contractor until delivery and acceptance of a satisfactory product.

The Contract Financing Payment balance of \$501.2 thousand is comprised of estimated future funded payments that will be paid to the contractor upon future delivery and government acceptance of a satisfactory product. (See additional discussion in Note 15, Other Liabilities).

Note 7. Cash and Other Monetary Assets

Not Applicable.

Note 8. Direct Loan and/or Loan Guarantee Programs

Not Applicable.

Note 9. Inventory and Related Property

As of September 30	2006	2005
<i>(Amounts in thousands)</i>		
1. Inventory, Net	\$ 431,512	\$ 541,020
2. Operating Materials & Supplies, Net	126,556	95,932
3. Stockpile Materials, Net	0	0
4. Total	\$ 558,068	\$ 636,952

Fluctuations and Abnormalities

Total Inventory and Related Property decreased \$78.9 million, 12%, from Fiscal Year (FY) 2005 to FY 2006. The majority of this decrease is attributable to Net Inventory and Operating Material & Supplies, primarily in the area of Navy Working Capital Fund, Marine Corps (NWCF, MC), Supply Management Activity Group (SMAG). These decreases are described in the follow-on explanations of this note.

Inventory, Net

As of September 30	2006			2005	Valuation Method
	Inventory, Gross Value	Revaluation Allowance	Inventory, Net	Inventory, Net	
(Amounts in thousands)					
1. Inventory Categories					
A. Available and Purchased for Resale	\$ 325,731	\$ (89,478)	236,253	\$ 327,928	LAC, MAC
B. Held for Repair	194,387	0	194,387	212,258	LAC, MAC
C. Excess, Obsolete, and Unserviceable	0	0	0	0	NRV
D. Raw Materials	0	0	0	0	MAC, SP,
E. Work in Process	872	0	872	834	LAC
F. Total	\$ 520,990	\$ (89,478)	431,512	\$ 541,020	AC

Legend for Valuation Methods:

Adjusted LAC = Latest Acquisition Cost, adjusted for holding gains and losses

NRV = Net Realizable Value

SP = Standard Price

O = Other

AC = Actual Cost

MAC = Moving Average Cost

2. Information Related to Inventory, Net:

Fluctuations and/or Abnormalities

Total Inventory, Net decreased by \$109.5 million, 20%, from FY 2005 to FY 2006. The explanations for the majority of this variance are addressed below.

Inventory category: Available and Purchased for Resale: From FY 2005 to FY 2006, decreased \$91.7 million, 28%.

The inventory allowance account increased \$86.4 million from FY 2005 to FY 2006. This is due to posting corrective actions resulting from a review, conducted in the 4th Quarter, FY 2005, by the Defense Finance and Accounting Service (DFAS) for all prior period inventory transactions. The result of this review was the creation and posting of two journal vouchers (JV) totaling \$91.1 million, which decreased the book value of the inventory financial line account. These two journal vouchers were recorded to adjust inventory values, which had previously been erroneously recorded as prior period adjustments during the previous inventory revaluations. The prior period adjustment transactions resulting from the inventory revaluation had not accounted for the decrease in inventory values.

Inventory Held for Repair: decreased \$17.9 million, 8%, from FY 2005 to FY 2006. This decrease is due to the completion and receipt of spare parts, which were sent to the Marine Corps' Maintenance Centers for repair and return. Upon return of these items, an adjustment is made to reflect the transfer of inventory from repair status and increase inventory available for resale. The majority of these adjustments were done in 1st Quarter, FY 2006, \$6.0 million and 4th Quarter, FY 200, \$10.0 million.

Restrictions of Inventory Use, Sale, or Disposition

Generally, there are no restrictions with regard to the use, sale, or disposition of inventory to applicable Department of Defense (DoD) activities and personnel. Other than specified safety and war reserve levels, established as a result of DoD and Marine Corps regulatory operations, inventory may be sold to foreign countries, state and local governments, private parties and contractors in accordance with DoD and Marine Corps policies and guidance or at the direction of the President.

Composition of Inventory

Except for the work in process, all inventory categories shown in the table above apply to the Supply Management Activities.

Inventory Categories. Inventory represents property that is held for (a) sale to customers, (b) in the process of supporting production for eventual sale to customers (c) to be consumed in the production of goods for sale or (d) in the provision of providing services for a fee.

Inventory Available and Purchased for Resale includes consumable spare and repair parts and repairable items owned and managed by NWCF, MC as well as consumable and repairable items are managed by other Military Services, such as the Defense Logistics Agency or the General Services Administration where NWCF, MC has permission to stock, store and sale. Material available and purchased for resale includes material held, due to various managerial decisions to support military or national contingencies.

Included in "Inventory Available and Purchased for Resale," is an amount of \$39.1 million for War Reserve Material for Supply Management, Marine Corps.

Federal Accounting Standards requires disclosure of the amount of Inventory Held for "Future Sale." The NWCF, MC currently has no Inventory included in this reporting period, which is being held for future sale. All inventory, included in Inventory Net through 4th Quarter, FY 2006 is currently planned for sale to customers in FY 2007 or retained for military or national contingencies. There is no management or valuation difference between the two categories.

Inventory Held for Repair is inventory that is in less than "ready for issue/sale" condition and requires repair to make suitable for sale. Some of the inventory items are more economical to repair than to procure. The Marine Corps, for its warfighting readiness, relies upon weapon systems and machinery that are no longer in commercial production. The NWCF, MC supports its customers' requests for certain items by repairing or rebuilding these items vice new acquisitions. This repair/rebuild process is an essential part of the Marine Corps' commitment as a "Force in Readiness" as well as supporting our other DoD customers in maintaining a ready, mobile, and armed military force.

Work in Process balances include costs related to the production or servicing of items, including direct material, direct labor, applied overhead and other direct costs. Work in Process also includes the value of finished products or completed services pending billing to the customer. Work in Process designation may also be used to accumulate the amount paid to a contractor under cost reimbursable contracts, including the amount withheld from payment to ensure performance, and the amount paid to other Government plants for accrued costs of end items of material ordered but not delivered.

Inventory Work in Process

Work in Process at Depot Maintenance activities is \$872.1 thousand and is included as inventory. This amount represents work that has been completed, expenses incurred, and waiting to be billed to the customer.

Operating Materials and Supplies, Net

As of September 30	2006			2005	
	OM&S Gross Value	Revaluation Allowance	OM&S, Net	OM&S, Net	Valuation Method
(Amounts in thousands)					
1. OM&S Categories					
A. Held for Use	\$ 126,556	\$ 0	\$ 126,556	\$ 95,932	SP, LAC
B. Held for Repair	0	0	0	0	SP, LAC
C. Excess, Obsolete, and Unserviceable	0	0	0	0	NRV
D. Total	\$ 126,556	\$ 0	\$ 126,556	\$ 95,932	

Legend for Valuation Methods:

Adjusted LAC = Latest Acquisition Cost, adjusted for holding gains and losses

NRV = Net Realizable Value

SP = Standard Price

O = Other

AC = Actual Cost

2. Information Related to Operating Materials and Supplies (OM&S), Net:

Fluctuations and Abnormalities

The OM&S Held for Use increased \$30.6 million, 32%, in FY 2006. The increase is attributable to Depot Maintenance Activity Group, Marine Corps. The increase in Operating Material and Supplies, Held for Use is attributable to an increase in material and supplies purchased for repairing/rebuilding battled damaged equipment returning from war. Some of the equipment returning from war is very material intensive due to missing or heavily damaged major component parts, requiring replacing or complete rebuild of some assets. In addition, the Armor Plating project has caused OM&S to increase substantially because of the materials required to build the Armor Kits to be installed on weapons systems. As a result of the diminishing supply of steel, the depots had to order the material in bulk to ensure the material was delivered in a timely manner to support the production schedule for armor. The most notable increases occurred in the 1st Quarter, FY 2006, \$14.0 million, 16.6% and the 2nd Quarter, FY 2006, \$23.5 million, 27.8%.

Restrictions on OM&S

Generally, there are no restrictions with regard to the use, sale, or disposition of OM&S applicable to the Department of Defense (DoD) activities.

Composition of OM&S

OM&S Held for Use represents property that is consumed during normal operations and includes consumable spare and repair parts for use on customer work by various activities. The items are recorded using different methodologies including actual, weighted-average and historical cost. Federal Accounting Standards requires disclosure of the amount of OM&S Held for "Future Use." The NWCF, MC reports that \$126.6 million of OM&S is categorized as Held for Future Use. All Inventory categories shown in the table above apply to the Depot Maintenance Activity Group, Marine Corps only.

Government Furnished Material (GFM) and Contractor Acquired Material (CAM)

Generally, the values of the NWCF, MC's GFM and CAM in the hands of contractors are not included in the OM&S values reported above. The DoD is presently reviewing its process for reporting these amounts in an effort to determine the appropriate accounting treatment and the best method to annually collect and report required information without duplicating information already in other existing logistics systems in accordance with Volume 6B, Chapter 10 of DoD Financial Management Regulation.

Other Disclosures Related to OM&S

No further disclosures required.

Stockpile Materials, Net

Not applicable.

Note 10. General PP&E, Net

As of September 30	2006					2005
	Depreciation/ Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation/ Amortization)	Net Book Value	Prior FY Net Book Value
<i>(Amounts in thousands)</i>						
1. Major Asset Classes						
A. Land	N/A	N/A	\$ 0	N/A	\$ 0	\$ 0
B. Buildings, Structures, and Facilities		20 Or 40	70,872	\$ (39,340)	31,532	29,519
C. Leasehold Improvements	S/L	lease term 2-5 Or	0	0	0	0
D. Software	S/L	10	0	0	0	0
E. General Equipment	S/L	5 or 10	66,235	(55,089)	11,146	12,569
F. Military Equipment	S/L	Various lease	0	0	0	0
G. Assets Under Capital Lease	S/L	term	0	0	0	0
H. Construction-in- Progress	N/A	N/A	5,597	N/A	5,597	8,436
I. Other			0	0	0	0
J. Total General PP&E			\$ 142,704	\$ (94,429)	\$ 48,275	\$ 50,524

¹Note 15 for additional information on Capital Leases

Legend for Valuation Methods:

S/L = Straight Line

N/A = Not Applicable

2. Information Related to General Property, Plant and Equipment (GPP&E):

Fluctuations and Abnormalities

There are no abnormalities to disclose and no variances equal to or greater than ten percent and or two percent of total assets to explain for FY 2006.

Military Equipment

Military equipment is reported on the financial statements of the United States Marine Corps (USMC) General Fund.

Heritage Assets and Stewardship Land

Heritage assets and stewardship land are reported on the financial statements of USMC General Fund.

Other Disclosures

Generally, with the Navy Working Capital Fund, Marine Corps, there are no restrictions on General PP&E.

Assets Under Capital Lease

Information Related to Assets Under Capital Lease:

The Navy Working Capital Fund, Marine Corps has no assets under capital lease.

Other Disclosures Related to Assets under Capital Lease

No further disclosures required.

Note 11. Liabilities Not Covered by Budgetary Resources

As of September 30	2006	2005
<i>(Amounts in thousands)</i>		
1. Intragovernmental Liabilities		
A. Accounts Payable	\$ 0	\$ 0
B. Debt	0	0
C. Other	0	0
D. Total Intragovernmental Liabilities	\$ 0	\$ 0
2. Nonfederal Liabilities		
A. Accounts Payable	\$ 0	\$ 0
B. Military Retirement Benefits and Other Employment-Related Actuarial Liabilities	29,595	26,667
C. Environmental Liabilities	0	0
D. Other Liabilities	0	0
E. Total Nonfederal Liabilities	\$ 29,595	\$ 26,667
3. Total Liabilities Not Covered by Budgetary Resources	\$ 29,595	\$ 26,667
4. Total Liabilities Covered by Budgetary Resources	\$ 105,818	\$ 104,625
5. Total Liabilities	\$ 135,413	\$ 131,292

6. Information Related to Liabilities Not Covered and Covered by Budgetary Resources:

Fluctuations and Abnormalities

Nonfederal Liabilities, Military Retirement Benefits and Other Employment-Related Actuarial Liabilities increased \$2.9 million, 11%. This increase is attributable to liabilities supporting the Navy Working Capital Fund, Depot Maintenance Activity Group (DMAG) in which 319 additional personnel were reported by Department of Labor (DOL) from FY 2005 to FY 2006. This account is adjusted at the end of each fiscal year based on DOL reported endstrength levels. While the actuarial liabilities are properly recorded, based on policy; the actual endstrength levels for DMAG contrasts with DOL data. The United Marine Corps (USMC) data reflects an FY 2006 decrease of 121 personnel.

Definitions

Liabilities Not Covered by Budgetary Resources are unfunded liabilities, which are not considered covered by budgetary resources. Unfunded liabilities are those in which budget authority has not been received and congressional action is needed before budgetary resources can be provided.

Other Disclosures Related to Liabilities Not Covered by Budgetary Resources

The \$29.6 million included in Military Retirement Benefits and Other Employment-Related Actuarial Liabilities represents Federal Employees' Compensation Act liabilities.

Note 12. Accounts Payable

As of September 30	2006			2005
	Accounts Payable	Interest, Penalties, and Administrative Fees	Total	Total
<i>(Amounts in thousands)</i>				
1. Intragovernmental Payables	\$ 6,382	\$ N/A	\$ 6,382	\$ 41,637
2. Nonfederal Payables (to the Public)	67,846	0	67,846	30,947
3. Total	\$ 74,228	\$ 0	\$ 74,228	\$ 72,584

4. Information Related to Accounts Payable:

Fluctuations and Abnormalities

Intragovernmental accounts payable decreased \$35.3 million, 85%, from FY 2005 to FY 2006. The decrease is primarily due to Defense Finance and Accounting Service (DFAS) recording a journal voucher to adjust intragovernmental accounts payables. For the period beginning in the 1st Quarter, FY 2006 and continuing through 4th Quarter, FY 2006, a DFAS originated Journal Voucher (JV) was recorded that reduced the United States Marine Corps (USMC) intragovernmental accounts payables to match the balances identified and reported by trading partners as intragovernmental liabilities. These entries assume that the reported accounts payables, prior to the entry, are misclassified between federal and non federal and are cumulative in the resulting inception to date accounts payable balances. The JV, recorded in the 4th Quarter, FY 2006 in the amount of \$41.5 million, reduced intragovernmental accounts payables for USMC and increased nonfederal accounts payable by the same amount.

Similar JVs were not processed in FY 2005 due to the fact that trading partner adjustments was being performed at the Navy Defense Working Capital Fund (DWCF) level not at the lower USMC level. If the \$41.5 million journal voucher had not occurred, the intragovernmental accounts payable would have increased \$6.2 million primarily due to Depot Maintenance Activity Group (DMAG) operations as explained below:

The DMAG intragovernmental accounts payable increased \$5.4 million from FY 2005 to FY 2006. This is primarily due to procuring increased levels of required material that supports Global War on Terror (GWOT) operations, related to the USMC Maintenance Centers performing repair workload on battle damaged equipment and requiring increased replacement of spare parts or material to complete the rebuild/repair. The majority of the material was ordered in the 1st Quarter, FY 2006 for the repair and return of major warfighting weapon systems and such as tanks, trucks, trailers and machine guns. These procurements to support GWOT continued throughout FY 2006 resulting in increased levels of accounts payable at the end of the FY.

Nonfederal accounts payable increased \$36.9 million, 119%, in FY 2006. This increase is primarily due to the DFAS journal voucher discussed above. The journal voucher processed in the 4th Quarter, FY 2006 for nonfederal accounts payable of \$41.5 million for trading partners is the major contributor of this increase. The trading partner journal vouchers were not processed in FY 2005 because trading partner and eliminating entries information were being performed at the Navy DWCF level not at the lower USMC level.

If the \$41.5 million journal vouchers had not occurred, nonfederal accounts payable would have increased \$2.0 million for Supply Management Activity Group (SMAG) and decreased \$5.9 million for DMAG as explained below:

The SMAG increased \$2.0 million from FY 2005 to FY 2006. This is due to receiving, primarily in the 4th Quarter, FY 2006, inventory purchased from commercial vendors for which an accounts payable liability was unliquidated as of the end of FY 2006. The inventory was purchased on government issued contracts to commercial sources to rebuild/repair spare parts such as radios and hydraulic steering units. The contracts were issued due to diminishing available inventory in SMAG accounts that were depleted due to high sales demand from customers requesting to purchase these items from SMAG to support the repair of weapons systems needed by the warfighters engaged in GWOT.

The DMAG decreased \$5.9 million from 4th Quarter, FY 2005 to 4th Quarter, FY 2006. This is due to disbursements made between 2nd and 4th Quarters, FY 2006, to complete receipt and payment of billings from vendors, thus relieving the accounts payable. The accounts payable was established, for the most part, in the 4th Quarter, FY 2005 when USMC Maintenance Centers purchased material and supplies to support GWOT established production line to produce for various customers multiple variations of armor plating for major warfighting weapon systems.

In summary, overall account payable increased \$1.6 million.

Undistributed Disbursements

Undistributed disbursements are the difference between disbursements/collections recorded at the transaction level to a specific obligation, payable, or receivable in the activity field records as opposed to those reported by the U.S. Treasury. The total undistributed disbursement amounts displayed in this note should agree with the undistributed amounts reported on the accounting reports. In-transit payments are payments that have been made for other agencies or entities that have not been recorded in their accounting records. These payments are applied to each entity's outstanding accounts payable balance at year-end.

Allocation of Undistributed Disbursements

The Department of Defense (DoD) policy is to allocate supported undistributed disbursements between federal and nonfederal categories based on the percentage of federal and nonfederal accounts payable. Unsupported undistributed disbursements are recorded in United States Standard General Ledger account 2120, disbursements in transit. The Navy Working Capital Fund, Marine Corps (NWCF, MC) does not follow this allocation policy. NWCF, MC allocates undistributed disbursements to nonfederal accounts payable.

Trading Partner Data

For the majority of intra-agency sales, NWCF, MC accounting systems does not capture specific trading partner data at the transaction level in a manner that facilitates trading partner aggregations. Therefore, NWCF, MC is unable to reconcile the majority of its intragovernmental accounts payable to the related intragovernmental accounts receivable that generated the payable. Through an ongoing Business Management Modernization Program, DoD intends to develop long-term systems improvements that will capture the data necessary to perform the required reconciliations. The USMC has outlined specific processes for review and implementation in DON Financial Improvement Plan that should provide some near-term solutions for this process.

Eliminating Adjustments

The DoD summary level seller accounts receivables were compared to NWCF, MC's accounts payable. An adjustment was posted to NWCF, MC's accounts payable based on the comparison with the accounts receivable of DoD Components providing goods and services to NWCF, MC. As required, adjustments were made to reclassify accounts payable from federal to nonfederal.

Other Disclosures Related to Accounts Payable

No further disclosures required.

Note 13. Debt

Not Applicable.

Note 14. Environmental Liabilities and Disposal Liabilities

This is not applicable to the Marine Corps Navy Working Capital Fund. Environmental Liabilities are captured under the United States Marine Corps General Fund.

Environmental Disclosures

Not Applicable.

Note 15. Other Liabilities

As of September 30	2006			2005
	Current Liability	Noncurrent Liability	Total	Total
<i>(Amounts in thousands)</i>				
1. Intragovernmental				
A. Advances from Others	\$ 0	\$ 0	\$ 0	\$ 11,945
B. Deposit Funds and Suspense Account Liabilities	0	0	0	0
C. Disbursing Officer Cash	0	0	0	0
D. Judgment Fund Liabilities	0	0	0	0
E. FECA Reimbursement to the Department of Labor	0	0	0	0
F. Other Liabilities	917	0	917	6,277
G. Total Intragovernmental Other Liabilities	\$ 917	\$ 0	\$ 917	\$ 18,222
<i>(Amounts in thousands)</i>				
2. Nonfederal				
A. Accrued Funded Payroll and Benefits	\$ 10,236	\$ 0	\$ 10,236	\$ 13,811
B. Advances from Others	35	0	35	0
C. Deferred Credits	0	0	0	0
D. Deposit Funds and Suspense Accounts	0	0	0	0
E. Temporary Early Retirement Authority	0	0	0	0
F. Nonenvironmental Disposal Liabilities				
(1) Military Equipment (Nonnuclear)	0	0	0	0
(2) Excess/Obsolete Structures	0	0	0	0
(3) Conventional Munitions Disposal	0	0	0	0
G. Accrued Unfunded Annual Leave	0	0	0	0
H. Capital Lease Liability	0	0	0	0
I. Other Liabilities	19,894	508	20,402	7
J. Total Nonfederal Other Liabilities	\$ 30,165	\$ 508	\$ 30,673	\$ 13,818
3. Total Other Liabilities	\$ 31,082	\$ 508	\$ 31,590	\$ 32,040

4. Information Related to Other Liabilities:

Fluctuations and Abnormalities

Intragovernmental

Total intragovernmental other liabilities had an overall decrease of \$17.3 million, 95%, in fiscal year (FY) 2006 due to the following:

Intragovernmental other liabilities for advances from others decreased \$11.9 million (100%), in FY 2006. This is due to instructions, provided by the Office of Secretary of the Defense (OSD), to correct the posting of advance payments for War Reserve Materials (WRM). The instructions provided that a FY 2005 posting of \$11.8 million advance payment for WRM was incorrectly posted and should be moved from intragovernmental advances to other gains and losses thus not affecting liabilities. The journal voucher (JV) to complete this action was completed in the 4th Quarter, FY 2006 as a part of the Supply Management Activity Group (SMAG) operations.

In addition, intragovernmental other liabilities for advances from others decreased due to corrective actions, taken in the 2nd Quarter, FY 2006 to properly post advances of \$145.1 thousand, collected for Depot Maintenance Activity Group (DMAG) operations from private industry to perform electronic repair work on radars as nonfederal advances from others.

Intragovernmental other liabilities decreased \$5.4 million, 85%, in FY 2006. This is primarily due to corrective actions taken, beginning in 1st Quarter, FY 2006, to reclassify \$5.2 million in accrued liabilities for commercial contracts, base support, and travel advances from intragovernmental other liabilities to nonfederal other liabilities. This was in support of DMAG operations.

Nonfederal

Total nonfederal other liabilities had an overall increase of a net \$16.9 million, 122 %, in FY 2006. The net change is attributable to increases in operations of \$16.8 million for DMAG and \$501.2 thousand for SMAG due to the following reasons:

Nonfederal other liabilities for accrued funded payroll and benefits decreased \$3.6 million, 25% in FY 2006. This is primarily due to a personnel decrease of 46 temporary civilian employees beginning in June 2006 thus reducing accrued benefits by \$3.2 million. The employees chose to seek permanent positions outside of DMAG.

Nonfederal advances from others increased \$34.6 thousand, 100%, in FY 2006. This is due to a combination of the following:

- a. Collection and billing, in FY 2006, advances from private industry for DMAG operations to perform various workload.
- b. Posting actions to correct a FY 2005 advance from private industry that was erroneously posted as intragovernmental vice nonfederal other liabilities: advances from others.

As of September 30, 2005, a balance of \$145.1 thousand remained from an advance collection provided for DMAG to perform work as explained above. The corrective action to properly post this advance increased nonfederal advances from others.

In addition, during the 1st and 3rd Quarters, FY 2006, advances totaling \$276.5 thousand were received from private industry. The major portion of these advances was for DMAG operations to perform repair work on transmissions.

Billings, during FY 2006 that decreased nonfederal advances, totaled \$387 thousand. The majority of the billings occurred during the 1st and 4th Quarters, FY 2006.

The net amount of the corrective action, advance collections and billings resulted in a September 30, 2006 advance collection balance of \$32.6 thousand.

Nonfederal other liabilities increased \$20.4 million, 285%, in FY 2006. This is due to the accrual of \$19.9 million for commercial contracts, host base support and travel advances. The increase began in 3rd Quarter, FY 2005, in order to support the increased workload related to Global War of Terror (GWOT).

For Supply Management, nonfederal other liabilities increased in FY 2006, \$501.2 thousand, 100%, due to the recording of anticipated future contract financing payments per OSD direction in September 2006.

In summary, total other liabilities decreased by \$451.4 thousand, 1.4%, due to explanations provided above.

Composition of Other Liabilities

Intragovernmental other liabilities represent liabilities for health and life insurance, retirement and other benefits and entitlements representing government contributions.

Nonfederal other liabilities include amounts that are significant portions of the total liabilities presented in the Navy Working Capital Fund, Marine Corps (NWCF, MC) Balance Sheet. A breakout of the major components of nonfederal other liabilities are as follows:

Other liabilities consists of accrued cost for travel advances, base support, and contracts for work performed by civilian personnel, contractors and other agencies in which a request for payment has not been received.

Per the Department of the Defense, Inspector General (DoDIG) Audit: "Financial Management: Report on Recording and accounting for DoD Contract Financing Payment, of May 10, 2005 and the Office of the Under Secretary of Defense (Comptroller) OUSD(C) direction, a contingent liability for outstanding contract financing payments based on cost in excess of progress payments was recognized for the first time in 4th Quarter, FY 2006. The recognized liability was derived from an OUSD(C) query of the Mechanization of Contract Administration System (MOCAS). The NWCF, MC field level account data does not reconcile with the MOCAS data, therefore the NWCF, MC cannot support this OUSD(C) directed adjustment. Also, current business processes and contract clauses do not support this OUSD(C) directed adjustment.

The remaining other liabilities consists of liabilities for progress payments, which are maintained to show the balance of payments taken for accrued costs charged to work in process. It was reclassified from contra-assets account to nonfederal other liabilities.

Intragovernmental Reconciliation for Fiduciary Transactions with Department of Labor (DOL)

With respect to the major fiduciary balances, NWCF, MC was able to reconcile with DOL.

For FY 2006, the Department of the Navy does not have any delinquent amounts due to the DOL for the FECA bill. The FY 2007 FECA bill is due to DOL 30 days after the appropriation bill is passed and signed.

Capital Lease Liability

Not Applicable.

Note 16. Commitments and Contingencies

Information Related to Commitments and Contingencies:

Legal Contingencies:

The Navy Working Capital Fund - Marine Corps (NWCF, MC), a sub-entity of the Navy Working Capital Fund, is a party in various administrative proceedings and legal actions, with claims including environmental damage claims, equal opportunity matters, and contractual bid protests which may ultimately result in settlements or decisions adverse to the Federal Government. These proceedings and actions arise in the normal course of operations and their ultimate disposition is unknown. For NWCF, MC cases, the Department of the Navy (DON) will accrue contingent liabilities for legal actions where DON Office of General Counsel considers an adverse decision probable and the amount of the loss is measurable. In the event of an adverse judgment against the Government, some of the liabilities may be payable from the judgment fund. Others may be payable from DON resources, either directly or by reimbursement to the Judgment Fund. In addition to DON statements, NWCF, MC records judgment fund liabilities in Note 15, "Other Liabilities" and Note 12, "Accounts Payable."

The Office of the Navy General Counsel conducted a review of litigation and claims threatened or asserted involving the NWCF, MC to which Office of General Counsel attorneys devoted substantial attention in the form of legal consultation or representation. This review utilizes a threshold of materiality of \$170.0 thousand applied to individual and aggregate claims, litigation, assessments, or contingencies arising out of a single event or a series of events.

The NWCF, MC has no cases that meet the existing materiality threshold. Therefore, no contingent liabilities were recorded nor is any disclosure of estimated contingencies required. This declaration is fully supported by the Preliminary and Final Legal Representation letters and the subsidiary management summary schedule.

In response to the Department of Defense, Inspector General audit, "Financial Management: DoD process for Reporting Contingent Legal Liabilities," the DON completed a methodology during FY 2006 that provides an estimate for those cases that are considered probable or reasonably possible to be settled against the government. The DON is testing the methodology with the objective to begin reporting 2nd Quarter FY 2007.

Other Commitments and Contingencies

The NWCF, MC does not have obligations related to cancelled appropriations for which the reporting entity has a contractual commitment for payment.

The NWCF, MC has contractual arrangements which may require future financial obligations (i.e. undelivered orders). These undelivered orders are estimated at \$333.6 million as of September 30, 2006. Included in this total is \$501.2 thousand, posted in the 4th Quarter, FY 2006 as a Defense Finance and Accounting Service (DFAS) Journal Voucher (JV) directed by the Office of the Under Secretary of Defense (OUSD) for Financial Management. This amount, which is included in the balance for nonfederal other liabilities is in support of contracting and related financing payments. As directed by the OUSD, no budgetary adjustments were considered to record the JV which adjusted contingent liabilities. The NWCF, MC has an internal weakness of creating budgetary accounts from proprietary accounts. The DFAS is currently working with the Department of Navy, as a part of its Financial Management Improvement Plan, to correct this weakness.

Note 17. Military Retirement and Other Federal Employment Benefits

As of September 30	2006				2005
	Present Value of Benefits	Assumed Interest Rate (%)	(Less: Assets Available to Pay Benefits)	Unfunded Liability	Present Value of Benefits
<i>(Amounts in thousands)</i>					
1. Pension and Health Actuarial Benefits					
A. Military Retirement Pensions	\$ 0		\$ 0	\$ 0	\$ 0
B. Military Retirement Health Benefits	0		0	0	0
C. Military Medicare-Eligible Retiree Benefits	0		0	0	0
D. Total Pension and Health Actuarial Benefits	\$ 0		\$ 0	\$ 0	\$ 0
2. Other Actuarial Benefits					
A. FECA	\$ 29,595		\$ 0	\$ 29,595	\$ 26,667
B. Voluntary Separation Incentive Programs	0		0	0	0
C. DoD Education Benefits Fund	0		0	0	0
D. Total Other Actuarial Benefits	\$ 29,595		\$ 0	\$ 29,595	\$ 26,667
3. Other Federal Employment Benefits	\$ 0		\$ 0	\$ 0	\$ 0
4. Total Military Retirement and Other Federal Employment Benefits:	\$ 29,595		\$ 0	\$ 29,595	\$ 26,667

Actuarial Cost Method Used:

Assumptions:

Market Value of Investments in Market-based and Marketable Securities:

5. Information Related to Military Retirement Benefits and Other Employment-Related Actuarial Liabilities:

Fluctuations and/or Abnormalities:

Military retirement benefits and other employment-related actuarial liabilities increased \$2.9 million, 11%. This increase is attributable to liabilities supporting the Navy Working Capital Fund, Depot Maintenance Activity Group (DMAG) in which 319 additional personnel were reported by Department of Labor (DOL) from FY 2005 to FY 2006. This account is adjusted at the end of each fiscal year based on DOL reported endstrength levels. While the actuarial liabilities are properly recorded, in accordance with policy, the actual endstrength levels for DMAG contrasts with DOL data. The United States Marine Corps data reflects a FY 2006 decrease of 121 personnel.

Actuarial Cost Method Used

The Department of the Navy (DON) actuarial liability for workers' compensation benefits is developed by the Department of Labor and provided to DON at the end of each fiscal year. The liability is distributed between the Navy Working Capital Fund, Marine Corps and DON General Fund based upon the number of civilian employees funded in each entity as reported in the Navy Budget Tracking System. The liability includes the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases. The liability is determined using a method that utilizes historical benefit payment patterns to predict the ultimate payments.

Assumptions

The projected annual benefit payments are discounted to the present value using Office of Management and Budget's economic assumptions for ten year U.S. Treasury notes and bonds. Cost-of-living adjustments and medical inflation factors are also applied to the calculation of projected future benefits. The interest rate assumptions used in the discount calculations are as follows for September 30, 2006:

2006

5.170% in Year 1

5.313% in Year 2 and thereafter

To provide more specifically for the effects of inflation on the liability for future workers' compensations benefits, wage inflation factors (cost of living adjustments or COLAs) and medical inflation factors (consumer price index medical or CPIMs) were applied to the calculation of projected future benefits. The actual rates for these factors for the charge back year (CBY) 2006 were also used to adjust the methodology's historical payments to current year constant dollars.

The compensation COLAs and CPIMs used in the projections for various charge back years were as follows:

CBY	COLA	CPIM
2006	3.50%	4.00%
2007	3.13%	4.01%
2008	2.40%	4.01%
2009	2.40%	4.013%
2010+	2.43%	4.09%

The model's resulting projections were analyzed to ensure that the estimates were reliable. The analysis was based on four tests:

- (1) a sensitivity analysis of the model to economic assumptions,
- (2) a comparison of the percentage change in the liability amount by agency to the percentage change in the actual incremental payments,

- (3) a comparison of the incremental paid losses per case (a measure of case-severity) in CBY 2006 to the average pattern observed during the most current three charge back years,
- (4) a comparison of the estimated liability per case in the 2006 projection to the average pattern for the projections of the most recent three years.

Market Value of Investments in Market-based and Marketable Securities

Not Applicable.

Changes in Actuarial Liability

There have been no changes in the calculation of actuarial liability since last reporting period.

Other Employment – Related Actuarial Liabilities

Other employment – related actuarial liabilities did not have any abnormalities to disclose and no variances equal to or greater than ten percent and or two percent of Actuarial Liabilities to explain for this reporting period. The balance of other employment-related actuarial liabilities is \$29.6 million, all of which is attributable to Federal Employees Compensation Act.

Note 18. General Disclosures Related to the Statement of Net Cost

Intragovernmental Costs and Exchange Revenue		
As of September 30	2006	2005
<i>(Amounts in thousands)</i>		
1. Intragovernmental Costs	\$ 255,735	\$ 523,005
2. Public Costs	475,129	136,650
3. Total Costs	\$ 730,864	\$ 659,655
4. Intragovernmental Earned Revenue	\$ (617,997)	\$ (684,468)
5. Public Earned Revenue	(90,965)	1,263
6. Total Earned Revenue	\$ (708,962)	\$ (683,205)
7. Net Cost of Operations	\$ 21,902	\$ (23,550)

8. Information Related to the Statement of Net Cost:

Fluctuations and Abnormalities

Net Cost of Operations increased \$45.5 million, 193%, in FY 2006. This increase is attributable to total costs increasing by \$71.2 million and total earned revenue increasing by \$25.7 million in FY 2006 when compared with FY 2005. The primary drivers for the \$71.2 million, 11%, increase in total costs are explained below:

- Depot Maintenance Activity Group (DMAG) experienced an increase of \$30.6 million in Operating Material and Supplies (OM&S) purchased for repairing/rebuilding battled damaged equipment returning from war. Some of the equipment returning from war is very material

intensive due to missing or heavily damaged major component parts, requiring replacing or complete rebuild of some assets. In addition, the Armor Plating project has caused OM&S to increase substantially because of the materials required to build the Armor Kits to be installed on weapons systems. The most notable increases occurred in the 1st Quarter, FY 2006, \$14.0 million and the 2nd Quarter, FY 2006, \$23.5 million.

- Due to the high demand during 3rd Quarter, FY 2005 from the Supply Management Activity Group (SMAG) customers to purchase inventory to support their engagement in the Global War on Terror (GWOT). This caused inventory levels, available for sale, to significantly deplete. As a result, SMAG obligated funds totaling \$22.2 million during the month of September 2006 to purchase inventory in order to replenish its inventory levels thus ensuring sufficient inventory availability in time to meet its customers' needs.
- During 3rd Quarter, FY 2006, the United States Marine Corps made a conscious decision to purchase, in bulk, chemical biological warfighting protective gear (gas masks) in anticipation of increased demand from customers of the SMAG. As a result, \$4.7 million was obligated to make a bulk purchase which took advantage of both cost and risk reduction strategies. The anticipated increase in demand was based on the anticipated change in enemy warfighting tactics from ground fighting to chemical warfare as well as identified concern based on limited available sources of supply for this type of gear.

The primary drivers for the \$25.7 million, 4%, which is over 2% of total assets, increase in total earned revenue are explained below:

- The Depot Maintenance Activity Group (DMAG) experienced an increase of \$5.2 million in total earned revenue due to billing additional direct labor hours and material cost associated with completion of workload as result of additional personnel hired to support the GWOT surge in customers orders. This resulted in an increase of \$27.6 million in FY 2006, as compared to FY 2005. The most notable increases occurred in the 4th Quarter, FY 2006, in which \$187.4 million in revenue was gained. In addition, a decrease adjustment for elimination entries of \$22.4 million occurred in the 4th Quarter, FY 2006 to reconcile the trial balance to USMC trading partner data. This was reported at the Department of the Navy level vice USMC Corp level prior to FY 2006.
- The Supply Management Activity Group (SMAG) experienced an increase of \$20.5 million in total earned revenue due to an inventory adjustment in the 4th Quarter, FY 2006 to correct the posting of advance payment for war reserves material in accordance to Office of Secretary of the Defense guidance. The instructions provided that a FY 2005 posting of \$11.8 million advance payment for War Reserve Material was incorrectly posted and should be moved from intragovernmental advances to other gains and losses thus not affecting liabilities. The remaining balance of \$8.7 million is primarily due to the net adjustment for elimination entries to reconcile the trial balance to USMC trading partner data in the 4th Quarter, FY 2006.

Composition of Statement of Net Cost

The NWCF, MC generally records transactions on an accrual basis as required by federal Generally Accepted Accounting Principles (GAAP). Information presented on the statement of net cost represents the net result of post-closing adjustments and eliminating entries made in compiling and consolidating NWCF, MC financial statements. These entries significantly affected the reported amounts of intragovernmental program cost, program cost with the public, earned revenue and net program cost. The post-closing adjustments were made in order to increase or decrease certain NWCF, MC account balances reported as of September 30, 2006 to ensure agreement with related balances reported by other Department of Defense (DoD) and other federal reporting entities. Eliminating entries are required adjustments made as part of the financial process. This process enables the matching of trading partner data recorded at each financial statement consolidation level: NWCF, DoD, and Federal Government levels.

Other Disclosures Related to the Statement of Net Cost

This statement is unique because its principles are driven by an understanding of net cost of programs and or organizations that the Federal Government supports through appropriations. This statement provides gross and net cost information that can relate to the amount of output for a given program and or organization administered by a responsible reporting entity.

Intragovernmental costs and revenues are related to transactions made between two reporting entities within the Federal Government.

Public costs and revenues are exchange transactions made between the reporting entity and a nonfederal entity.

Although NWCF, MC is able to compare its intragovernmental costs and revenues with corresponding balances of its intragovernmental trading partners, it is unable to validate these balances. There were no material differences identified during FY 2006.

The NWCF, MC does not report any heritage assets or stewardship land, as these entities are reported on the financial statements of the Department of the Navy General Fund.

For FY 2006, NWCF, MC's financial management systems are unable to meet all of the requirements for full accrual accounting. Many of NWCF, MC's financial and nonfinancial feeder systems and processes were designed and implemented prior to the issuance of GAAP for federal agencies. These systems were not designed to collect and record financial information on the full accrual accounting basis as required by GAAP. The NWCF has undertaken efforts to determine the actions required to bring its financial and nonfinancial feeder systems and processes into compliance with GAAP. One such action is the current revision of its accounting systems to record transactions based on the US Standard General Ledger. Until all of NWCF, MC's financial and nonfinancial feeder systems and processes are updated to collect and report financial information as required by GAAP, NWCF, MC's financial data will be based on transactions from nonfinancial feeder systems, and adjustments for known accruals of major items such as payroll expenses, accounts payable, and environmental liabilities.

In addition, NWCF, MC identifies program costs based upon business areas. Current processes and systems do not capture and report accumulated costs for major programs based upon the performance measures as required by the Government Performance and Results Act. The NWCF, MC is in the process of reviewing available data and attempting to develop a cost reporting methodology that balances the need for cost information, as required by the Statement of Federal Financial Accounting Standards No. 4, "Managerial Cost Accounting Concepts and Standards for the Federal Government," with the need to keep the financial statements from being overly voluminous.

Note 19. Disclosures Related to the Statement of Changes in Net Position

As of September 30	2006		2005	
	Cumulative Results of Operations	Unexpended Appropriations	Cumulative Results of Operations	Unexpended Appropriations
<i>(Amounts in thousands)</i>				
1. Prior Period Adjustments				
Increases (Decreases) to Net Position Beginning Balance				
A. Changes in Accounting Standards	\$ 0	\$ 0	\$ 0	\$ 0
B. Errors and Omissions in Prior Year Accounting Reports	0	0	0	0
C. Total Prior Period Adjustments	\$ 0	\$ 0	\$ 0	\$ 0
2. Imputed Financing				
A. Civilian CSRS/FERS Retirement	\$ 3,426	\$ 0	\$ 3,116	\$ 0
B. Civilian Health	8,879	0	6,945	0
C. Civilian Life Insurance	22	0	18	0
D. Judgment Fund	0	0	0	0
E. IntraEntity	0	0	0	0
F. Total Imputed Financing	\$ 12,327	\$ 0	\$ 10,079	\$ 0

3. Information Related to the Statement of Changes in Net Position:

Fluctuations and Abnormalities

Total Imputed Financing increased \$2.2 million, 22%, in Fiscal Year (FY) 2006. The variance is due to the increased government estimated cost/allocation process related to the civilian employee entitlements for retirement and insurance and any increase or decrease in the estimated cost/allocation factors and the actual amounts provided by Office of Personnel Management (OPM) on a quarterly basis. The estimated and actual cost variance is primarily driven by the increase in personnel within the Marine Corps' Depot Maintenance Activity Group beginning in 2nd Quarter, FY 2005 and has progressively increased through 4th Quarter, FY 2006. The additional employees are primarily temporary and term employees who were hired to complete workload requested by the customers supporting Global War on Terror (GWOT).

Imputed Financing

The amounts remitted to OPM by and for employees covered by the Civil Service Retirement System, Federal Employee Retirement System, Federal Employee Health Benefits Program and the Federal

Employee Group Life Insurance Program do not fully cover the Government's cost to provide these benefits. An imputed cost is recognized as the difference between the Government's cost of providing these benefits to the employees and contributions made by and for them. The OPM provides the cost factors to the Defense Finance and Accounting Service (DFAS) for computation of imputed financing cost. The DFAS provides the costs to Office of the Under Secretary of Defense (Personnel and Readiness) for validation. Approved imputed costs are provided to the reporting components for inclusion in their financial statements.

Note 20. Disclosures Related to the Statement of Budgetary Resources

As of September 30	2006	2005
<i>(Amounts in thousands)</i>		
1. Net Amount of Budgetary Resources Obligated for Undelivered Orders at the End of the Period	\$ 227,740	\$ 200,113
2. Available Borrowing and Contract Authority at the End of the Period	1,232,543	1,216,003

3. Information Related to the Statement of Budgetary Resources:

The Statement of Budgetary Resources (SBR) is an image of the monthly Report on Budget Execution. These reports should be produced using budgetary accounts. However, Navy Working Capital Fund, Marine Corps (NWCF, MC) uses proprietary accounts because its financial accounting systems were not initially designed to produce budgetary accounting data. The United States Marine Corps (USMC) and Defense Finance and Accounting Service (DFAS) continue with the implementation of new accounting systems designed to produce both proprietary and budgetary reports and use the US Standard General Ledger (USSGL).

Change in Receivables from Federal Sources includes USSGL 4251 account, reimbursements and other income earned. The amount presented on this line is the ending balance less the beginning balance for the current fiscal year. In this case the ending balance is less than the beginning balance, which nets to a negative value change for this fiscal year. The net negative value change is a reflection of USMCs' aggressive efforts to collect on reimbursable operations; the fuel business transferred to Defense Logistics Agency; collections of aged outstanding fuel receivables and the continuing efforts between DFAS partnering with USMC to reduce accounts receivable.

For SBR, Supply Management's revenue is defined as gross sales less credit returns. For the balance sheet, revenue does not include credit returns because the inventory valuation model considers credit returns as inventory allowances. The difference in "meanings" causes variances in the reports.

As of September 30, 2006, the differences between U.S. Treasury and NWCF, MC activity ledgers have been minimal. The principal cause of the difference is related to timing issues or type of transactions. The differences are recorded as undistributed disbursements and collections on the departmental reports. While there may be no impact upon U.S. Treasury balance, the above differences have created distortions in the accounts receivable and accounts payable on SBR. Accounting and accounting relationship issues involving the treatment of undistributed collections and disbursements have created abnormal balances for accounts receivable and accounts payable on SBR.

Intra-entity Transactions

The SBR does include intra-entity transactions, which have not been eliminated because the statements are presented as combined and combining.

Apportionment Categories

The Office of Management and Budget Circular A-136 requires disclosure of the amount of direct and reimbursable obligations incurred against amounts apportioned under categories A, B and exempt from apportionment. These amounts are as follows:

(Amounts in thousands)

Obligations Incurred – Direct	\$0
Obligations Incurred – Reimbursable	\$694,405
Exempt from apportionment	\$0

Undelivered Orders

Undelivered Orders presented in SBR includes undelivered orders-unpaid for both direct and reimbursable funds.

Spending Authority from Offsetting Collections

Adjustments in funds that are temporarily not available pursuant to Public Law, and those that are permanently not available, are not included in the Spending Authority from Offsetting Collections and Adjustments line on SBR or the Spending Authority for Offsetting Collections and Adjustments line on the Statement of Financing.

Other Disclosures Related to the Statement of Budgetary Resources

The information contained in this note represents a subset of the information portrayed in, “Unpaid Obligations” and “Gross Outlays” of the Statement of Budgetary Resources and is reconcilable back to the applicable general ledger accounts.

The NWCF, MC does not have any legal arrangements affecting the use of unobligated balances of budget authority such as time limits, purpose, and obligation limitations.

The NWCF, MC did not receive any capital infusion during the reporting period including the amount, the source, and the reason for these additional funds.

Note 21. Disclosures Related to the Statement of Financing**Information Related to the Statement of Financing:**

The Statement of Financing is designed to provide information about the total resources used by an entity, to explain how those resources were used to finance orders for goods and services not yet delivered, to acquire assets and liabilities, and to fund the entity’s net cost of operations. It is designed to report the differences and facilitate the reconciliation of accrual based amounts used in the Statement of Net Cost and obligation-based amounts used in the Statement of Budgetary Resources (SBR). The computations and presentation of items in the Statement of Financing demonstrate that the budgetary and proprietary information in an entity’s financial management system are in agreement.

Due to the financial system limitations, budgetary data is not in agreement with proprietary expenses and assets capitalized. The difference between budgetary and proprietary data has been previously identified as a system deficiency. To bring the Statement of Financing into balance with the Statement of Net Cost, the following adjustments (absolute value) were made:

Resources That Finance the Acquisition of Assets: \$177.2 million

The following Statement of Financing lines are presented as combined instead of consolidated due to intra-agency budgetary transactions not being eliminated:

- Obligations Incurred
- Less: Spending Authority from Offsetting Collections and Recoveries
- Obligations Net of Offsetting Collections and Recoveries
- Net Obligations
- Undelivered Orders
- Unfilled Orders.

Resources That Finance the Acquisition of Assets:

For Navy Working Fund, Capital Marine Corps (NWCF, MC), the various automated and manual financial management and feeder systems do not record transfers of material purchases to the various fixed asset categories at the time of receipt. The current financial process produces the proprietary general ledger account transactions that result in amounts equating to the value of inventory received, recorded as a asset prior to being expensed and thereafter, during the month, applied to cost of goods sold depending on time of sale and financial system updates..

Composition of Other Lines

There are four “Other” lines on the Consolidated Statement of Financing during FY 2006. The compositions of those lines are described below:

Resources Used to Finance Items not Part of the Net Cost of Operations

The amount reported as “Other” is related to inventories, included in Supply Management Activity Group (SMAG), that are the United States Marine Corps (USMC) special project inventory which is not owned nor purchased by SMAG. This inventory is replenishment and repair parts supporting the Fleet Marine Forces warfighting weapon systems that were received at the USMCs’ Intermediate Level Supply Warehouse as an interim storage for special projects and other management decisions of supply management. These items are included in SMAG as it is the single source for the USMC to comply with the Department of Defense regulations for total asset visibility requirements are not a part of SMAG operations and separately identified in the supply management system by project codes. At the end of each month, this inventory is decapitalized in order to reduce the inventory value to the amount purchased and owned by SMAG.

Resources Used to Finance Items not Part of the Net Cost of Operations, Other

The amount reported as other resources is transfers of assets out of NWCF, MC inventory.

Components Not Requiring or Generating Resources in Future Period, Other

The amount reported is the NWCF, MC actuarial liabilities for military retirement benefits.

Components Not Requiring or Generating Resources from Cost of Goods Sold

The amount reported as other consists of the NWCF, MC cost of goods sold.

Other Disclosures

There were no allocation transfers and abnormal balances to disclose.

Liabilities not covered by budgetary resources consist of nonentity assets (interest, penalties, fines and administrative fees) and Military Retirement Benefits and Other Employment Actuarial Liabilities for the Navy Working Capital Fund, Marine Corps (NWCF, MC). There are no amounts for resources in future periods for the Navy Working Capital Fund, as revenues are generated to cover liabilities during current years. Therefore, amounts reported as requiring resources in future periods do not have a relationship to liabilities not covered by budgetary resources.

Note 22. Disclosures Related to the Statement of Custodial Activity

Not Applicable.

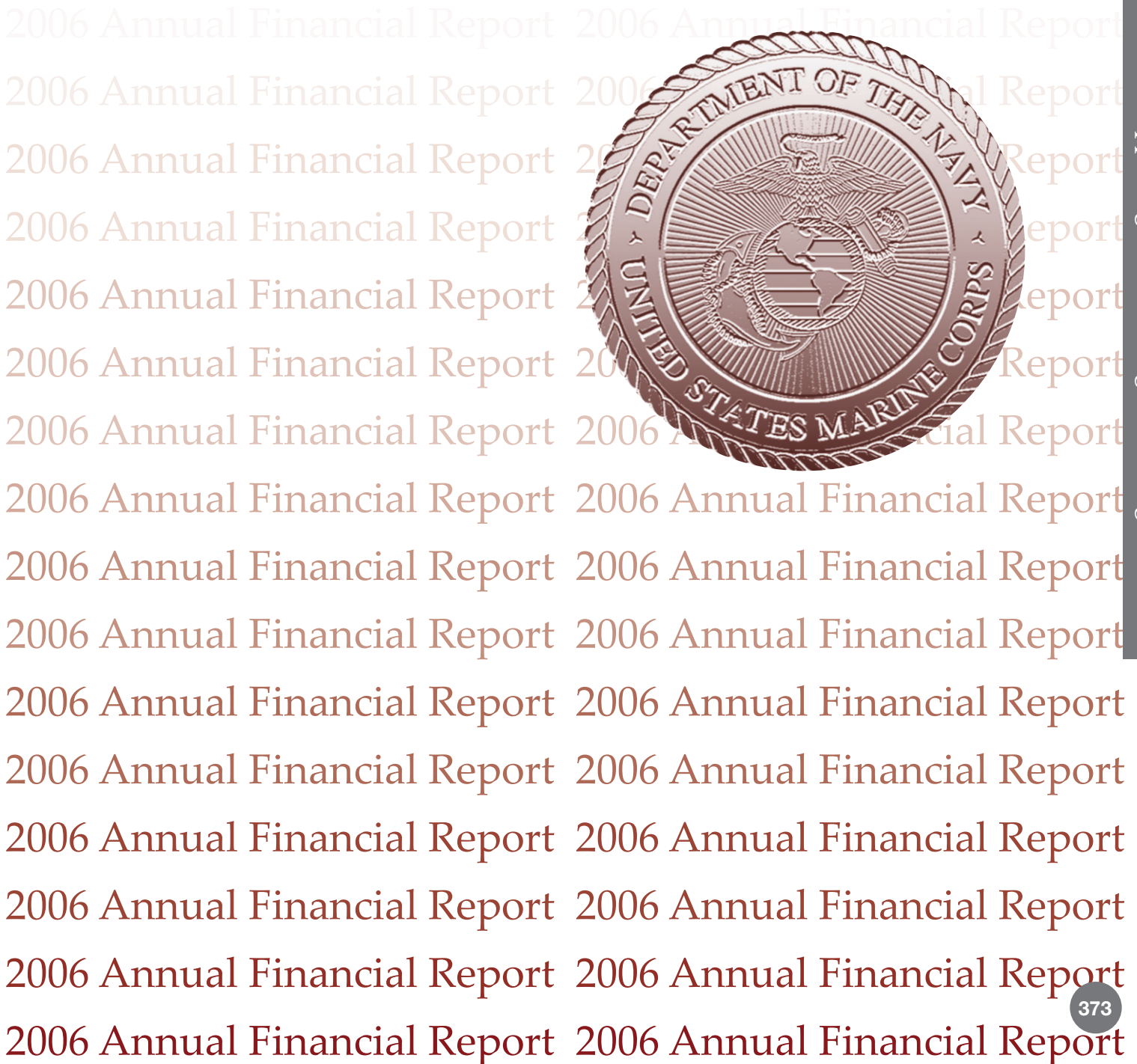
Note 23. Earmarked Funds

Not Applicable.

Note 24. Other Disclosures

Not Applicable.

Joining/Combining Statements





The United States Marine Corps, as a sub-entity of the Department of the Navy (DON), does not prepare Supporting/Consolidating Statements and therefore is included at the Navy Working Capital Fund level.

Department of the Navy Subsidiary Financial Statements

Navy Working Capital Fund – Marine Corps
Required Supplementary Information

2006



2006 Annual Financial Report 2006 Annual Financial Report
2006 Annual Financial Report 2006 Annual Financial Report
2006 Annual Financial Report 2006 Annual Financial Report
2006 Annual Financial Report 2006 Annual Financial Report
2006 Annual Financial Report 2006 Annual Financial Report
2006 Annual Financial Report 2006 Annual Financial Report
2006 Annual Financial Report 2006 Annual Financial Report
2006 Annual Financial Report 2006 Annual Financial Report
2006 Annual Financial Report 2006 Annual Financial Report
2006 Annual Financial Report 2006 Annual Financial Report
2006 Annual Financial Report 2006 Annual Financial Report
2006 Annual Financial Report 2006 Annual Financial Report
2006 Annual Financial Report 2006 Annual Financial Report
2006 Annual Financial Report 2006 Annual Financial Report
2006 Annual Financial Report 2006 Annual Financial Report
2006 Annual Financial Report 2006 Annual Financial Report
2006 Annual Financial Report 2006 Annual Financial Report
2006 Annual Financial Report 2006 Annual Financial Report

**Navy Working Capital Fund, Marine Corps
General Property, Plant, and Equipment
Real Property Deferred Annual Sustainment and Restoration Tables**
As of September 30, 2006
(\$ in Millions)

Annual Sustainment FY 2006				
	Required	Actual	Difference	
Marine Corps	8	5	3	
Building, Structures, and Utilities	8	5	3	

Annual Deferred Sustainment Trend				
	FY 2003	FY 2004	FY 2005	FY 2006
Marine Corps	-	-	-	3
Building, Structures, and Utilities	-	-	-	3

Restoration and Modernization Requirements				
	End FY 2005	End FY 2006	Change	
Marine Corps	-	8	8	
Building, Structures, and Utilities	-	8	8	

Narrative Statement:

Fiscal Year (FY) 2006 represents the fifth year the Facility Sustainment Model (FSM) was utilized for the Navy Working Capital Fund (NWCF). However, Fiscal Year 2006 is the first year that the United States Marine Corps (USMC) is reporting as a separate entity. Sustainment is defined as the maintenance and repair activities necessary to keep a facility in good working order over its service life. Sustainment includes regularly scheduled adjustments and inspections (such as for fire sprinkler heads and Heat Ventilation Air Condition systems), regulatory inspections (of elevators, bridges, and the like), emergency and routine preventive maintenance tasks, and major repair or replacement of facility components, such as roof replacement, refinishing wall surfaces, repairing and replacing electrical, heating, and cooling systems, and replacing tile and carpeting. In FY 2006, FSM Version 7.2 was used for programming and budgeting for facilities sustainment. Deferred amounts were calculated in accordance with the methodology provided by the Department of Defense (DoD) Financial Management Regulation, Volume 6B, Chapter 12. Since sustainment execution is tied to the NWCF, Marine Corps (MC) rate structure, the full requirement cannot be budgeted in a single year because the rate structure would not be affordable to NWCF, MC customers.

Restoration and Modernization is currently not modeled. Restoration includes repair and replacement work to restore facilities damaged by inadequate sustainment, excessive age, disaster, accident, or other causes. Modernization includes alteration of facilities solely to implement new or higher standards and regulatory changes, to accommodate new functions including base realignment and closure, or to renew building components that typically last more than 50 years such as foundations and structural members. Requirements listed in the table are actual expenditures for restoration and modernization by year. The requirements include restoration and modernization that is part of minor construction projects.

The NWCF, MC has no material amounts of deferred sustainment for the General Property, Plant, and Equipment categories of Personal Property, Heritage Assets, or Stewardship Land.

Accompanying Information



Appropriations, Funds, and Accounts Included in the Financial Statements

Reporting Entity

Navy Working Capital Fund (NWCF)

Fund/Account Treasury Symbol and Title:

97X4930.002

Navy Working Capital Fund Activity Group Treasury Symbol and Title:

97X4930.NA4A* Depot Maintenance- Other, Marine Corps

97X4930.NC2A* Supply Management, Marine Corps

Notes

* - The "*" represents alpha or numeric characters which identify an activity or reporting segment of the activity group.

Audit Opinions





INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-4704

November 8, 2006

MEMORANDUM FOR ASSISTANT SECRETARY OF THE NAVY (FINANCIAL
MANAGEMENT AND COMPTROLLER)

SUBJECT: Independent Auditor's Report on the Fiscal Year 2006 Department of the Navy
General Fund Financial Statements (Report No. D-2007-011)

The Chief Financial Officers Act of 1990, as amended, requires the Department of Defense Inspector General to audit the accompanying Department of the Navy General Fund Consolidated Balance Sheet as of September 30, 2006 and 2005, the related Consolidated Statement of Net Cost, the Consolidated Statement of Changes in Net Position, the Combined Statement of Budgetary Resources, and the Combined Statement of Financing for the fiscal years then ended. The financial statements are the responsibility of Department of the Navy management. The Navy is also responsible for implementing effective internal control and for complying with laws and regulations. We are unable to give an opinion on the Navy General Fund Fiscal Year 2006 financial statements because of limitations on the scope of our work. Thus, the financial statements may be unreliable. In addition to our disclaimer of opinion on the financial statements, we are including the required Report on Internal Control and Compliance with Laws and Regulations. The Report on Internal Control and Compliance with Laws and Regulations is an integral part of our disclaimer of opinion on the financial statements and should be considered in assessing the results of the audit.

Disclaimer of Opinion on the Financial Statements

The Assistant Secretary of the Navy (Financial Management and Comptroller) acknowledged to us that material deficiencies still exist in the Navy General Fund financial statements. Therefore, we did not perform auditing procedures to determine whether material amounts on the financial statements were fairly presented. We did not perform these and other auditing procedures because Section 1008(d) of the FY 2002 National Defense Authorization Act limits the Department of Defense Inspector General to perform only audit procedures required by generally accepted government auditing standards that are consistent with the representations made by management. The Navy has also acknowledged, and prior audits have identified, the material weaknesses listed in the Summary of Internal Control. These material weaknesses also affect the reliability of certain information contained in the annual financial statements—much of which is taken from the same data sources as the basic financial statements.¹ Therefore, we are unable to express, and we do not express, an opinion on the basic financial statements. Additionally, the purpose of the audit was not to express an opinion on the information accompanying the basic financial statements. Accordingly, we express no opinion on the accompanying information.

¹ The annual financial statements include the basic financial statements, management discussion and analysis, consolidating and combining financial statements, Required Supplementary Stewardship Information, Required Supplementary Information, and Other Accompanying Information.

Summary of Internal Control

In planning our audit, we considered Navy internal control over financial reporting and compliance. We did this to determine our procedures for auditing the financial statements and to comply with Office of Management and Budget guidance, but our purpose was not to express an opinion on internal control. Accordingly, we do not express an opinion on internal control over financial reporting and compliance. However, previously identified reportable conditions, all of which are material, continued to exist in the following areas:

- Accounting and Financial Management Systems
- Fund Balance With Treasury
- Accounts Receivable
- Inventory and Related Property, Net
- General Property, Plant, and Equipment
- Accounts Payable
- Environmental Liabilities
- Problem Disbursements
- Unobligated Balances

Material weakness are reportable conditions in which internal controls do not reduce (to a relatively low level) the risk of misstatements that are material to the financial statements and that might not be timely detected by employees while performing their normal assigned functions.

Reportable conditions are matters coming to the auditor's attention that, in his or her judgment, should be communicated to management because they represent significant deficiencies in the design or operation of internal control, which could adversely affect the organization's ability to initiate, record, process, and report financial data consistent with the assertions of management in financial statements. We performed financial-related audit work in DoD that was not part of the Chief Financial Officers audit in which we identified weaknesses in Accounts Receivable and Accounts Payable transactions, which we consider to be reportable conditions.

Our internal control work (conducted during prior audits) would not necessarily disclose all reportable conditions. The Attachment offers additional details on reportable conditions, most of which we consider to be material internal control weaknesses.

Summary of Compliance with Laws and Regulations

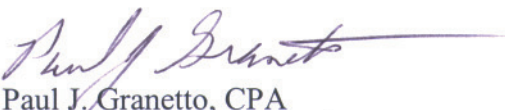
Our work to determine compliance with selected provisions of applicable laws and regulations related to financial reporting was limited because management acknowledged, and prior audits confirm, that instances of noncompliance continue to exist. The Assistant Secretary of the Navy (Financial Management and Comptroller) acknowledged to us that critical financial management and feeder systems do not comply with Federal financial systems requirements, Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level,

as required under the Federal Financial Management Improvement Act of 1996. Therefore, we did not determine whether the Navy was in compliance with all applicable laws and regulations related to financial reporting. Providing an opinion on compliance with certain provisions of laws and regulations was not an objective of our audit and, accordingly, we do not express such an opinion. See the Attachment for additional details on compliance with laws and regulations.

Management Responsibility

Management is responsible for:

- preparing the financial statements in conformity with generally accepted accounting principles;
- establishing, maintaining, and assessing internal control to provide reasonable assurance that the broad control objectives of the Federal Managers' Financial Integrity Act are met; and
- complying with applicable laws and regulations.


Paul J. Granetto, CPA
Assistant Inspector General and Director
Defense Financial Auditing Service

Attachment:
As stated

Report on Internal Control and Compliance with Laws and Regulations

Internal Control

Management is responsible for implementing and maintaining effective internal control and for providing reasonable assurance that accounting data are accumulated, recorded, and reported properly; the requirements of applicable laws and regulations are met; and assets are safeguarded against misappropriation and abuse. Our purpose was not to, and we do not, express an opinion on internal control over financial reporting. However, we have identified the following material weaknesses and reportable conditions that could adversely affect a favorable opinion on internal control.

Material Weaknesses. Management acknowledged that previously identified reportable conditions, all of which are material, continue to exist.

Accounting and Financial Management Systems. Navy financial system deficiencies include the inability to implement elements of generally accepted accounting principles and inadequate implementation of the U.S. Government Standard General Ledger.

Fund Balance With Treasury. Deficiencies associated with the Fund Balance With Treasury include: unmatched disbursements and collections; “suspense” accounts not cleared in a timely manner; check discrepancies; undistributed disbursements, collections, and abnormal balances; and an inability to reconcile Navy records with the Department of Treasury’s records.

Accounts Receivable. Intragovernmental accounts receivable may be overstated because of outstanding, over-aged reimbursable work orders. Seller-side trading partner data are neither captured nor maintained at a transaction-level detail, or may be missing or incomplete because of system deficiencies. Accounts receivable balances with the public may not be complete or accurate and unmatched collections are posted to the accounts receivable account, leaving no audit trail.

Inventory and Related Property, Net. The legacy systems currently used do not maintain the historical cost data necessary to comply with Statement of Federal Financial Accounting Standards No. 3, “Accounting for Inventory and Related Property.” In addition, completeness issues exist because these legacy systems were not designed to ensure that all of the inventory items are included in the values reported on the Balance Sheet. Some Navy commands have not used the consumption method for expensing Operating Materials and Supplies as specified in Statement of Federal Financial Accounting Standards No. 3. Also, some commands are unable to provide Operating Materials and Supplies at the detailed transaction level and only maintain beginning and ending balances.

General Property, Plant, and Equipment. Completeness issues still exist associated with recognizing internal use software and leasehold improvements. Trading partner data for capitalizing assets may not always be recorded. The Navy is currently working with the Office of the Under Secretary of Defense (Acquisition, Technology, and Logistics) and Navy major commands to fully implement Statement of Federal Financial Accounting Standards No. 23, “Eliminating the Category National Defense Property, Plant, and Equipment.” In addition, the Navy is working with the Office of the Under Secretary of Defense (Comptroller) to ensure that documentation for real property is available beginning with FY 1999 and that Form DD 1354, “Transfer and Acceptance of Military Real Property” is properly used throughout the Department of the Navy.

Accounts Payable. Intragovernmental accounts payable such as Military Standard Requisition and Issue Procedures, fuel payables, and non-PowerTrack transportation charges are not being recorded timely, completely, or accurately. The Navy lacks sufficient systems, processes, and data to support reconciliation of buyer-side trading partner information. Accounts payable with the public are not being recorded timely, completely, or accurately. Also, some Navy accounting procedures create abnormal balances.

Environmental Liabilities. Non-Defense Environmental Restoration Program liabilities are not being reported.

Problem Disbursements. Inaccurate or missing fund accounting codes have resulted in unmatched disbursements and collections requiring use of suspense accounts. The suspense accounts cause difficulty in reconciling Navy General Fund records with the Department of Treasury's records.

Unobligated Balances. Deficiencies exist in recorded unobligated amounts because financial systems are not fully integrated and not all commands sufficiently reviewed unliquidated obligations. Additionally, reimbursable transactions were not properly documented or reported on the Disbursing Officer Statement of Accountability.

Other Reportable Conditions. We noted deficiencies related to Accounts Receivable and Accounts Payable transactions during our FY 2006 financial-related audits. Our audit, "Accounting for Department of the Navy General Fund Accounts Receivable," Report No. D-2007-004, reported that unsupported departmental-level trading partner adjustments were processed. Additionally, a universe of Accounts Receivable transactions was not provided timely, which impacted our ability to perform the audit. Our audit, "Navy General Fund Vendor Payments Processed by Defense Finance and Accounting Service," Project No. D2005-D000FC-0151.000, reported that Accounts Payable transactions were not established timely, resulting in a potential misstatement. In addition, our audit identified transactions that were unsupported or contained material errors.

These financial management deficiencies are indications of material weaknesses and reportable conditions in internal control that may adversely affect any decision by the Navy that is based, in whole or in part, on information that is inaccurate because of these deficiencies. Financial information reported by DoD may also contain misstatements resulting from these deficiencies.

Compliance with Laws and Regulations

Management is responsible for compliance with existing laws and regulations related to financial reporting. Our work to determine compliance with selected provisions of the applicable laws and regulations was limited because management acknowledged instances of noncompliance, and previously reported instances of noncompliance continue to exist. Therefore, we did not determine whether the Navy was in compliance with selected provisions of all applicable laws and regulations related to financial reporting. Our objective was not to, and we do not, express an opinion on compliance with applicable laws and regulations.

Federal Financial Management Improvement Act of 1996. The Navy is required to establish and maintain financial management systems that comply substantially with Federal financial management system requirements, applicable Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level. The Navy acknowledged to us that many of the financial management systems do not comply substantially with Federal financial management system requirements, generally accepted accounting principles, and the U.S. Government Standard General Ledger at the transaction level.

Federal Managers' Financial Integrity Act of 1982. The Navy is required to evaluate its systems of internal accounting and administrative control and to report annually on whether those systems are in compliance with applicable requirements. The Navy performed an assessment of the effectiveness of the Navy General Fund internal controls regarding the reliability of financial reporting, compliance with applicable laws and regulations, and reliability of performance reporting. As a result of this assessment, the Navy identified material weaknesses related to financial reporting of the following:

- Accounts Payable,
- Environmental Liabilities,
- Military Equipment,
- Inventory and Operating Materials and Supplies,
- Fund Balance With Treasury, and
- Real Property Assets.

Audit Disclosures

The Assistant Secretary of the Navy (Financial Management and Comptroller) acknowledged to us on November 8, 2006, that the Navy General Fund financial management systems cannot provide adequate evidence supporting various material amounts on the financial statements. Therefore, we did not perform detailed testing related to previously identified material weaknesses. In addition, we did not perform audit work related to the following selected provisions of laws and regulations: Provisions Governing Claims of the United States Government, Pay and Allowance System for Civilian Employees, the Antideficiency Act, and the Federal Credit Reform Act.

This report does not include recommendations to correct the material internal control weaknesses and instances of noncompliance because previous audit reports contained recommendations for corrective actions, or audit projects currently in process will include appropriate recommendations.



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-4704

November 8, 2006

MEMORANDUM FOR ASSISTANT SECRETARY OF THE NAVY (FINANCIAL
MANAGEMENT AND COMPTROLLER)

SUBJECT: Independent Auditor's Report on the Fiscal Year 2006 Department of the Navy
Working Capital Fund Financial Statements (Report No. D-2007-012)

The Chief Financial Officers Act of 1990, as amended, requires the Department of Defense Inspector General to audit the accompanying Department of the Navy Working Capital Fund Consolidated Balance Sheet as of September 30, 2006 and 2005, the related Consolidated Statement of Net Cost, the Consolidated Statement of Changes in Net Position, the Combined Statement of Budgetary Resources, and the Combined Statement of Financing for the fiscal years then ended. The financial statements are the responsibility of Department of the Navy management. The Navy is also responsible for implementing effective internal control and for complying with laws and regulations. We are unable to give an opinion on the Navy Working Capital Fund Fiscal Year 2006 financial statements because of limitations on the scope of our work. Thus, the financial statements may be unreliable. In addition to our disclaimer of opinion on the financial statements, we are including the required Report on Internal Control and Compliance with Laws and Regulations. The Report on Internal Control and Compliance with Laws and Regulations is an integral part of our disclaimer of opinion on the financial statements and should be considered in assessing the results of the audit.

Disclaimer of Opinion on the Financial Statements

The Assistant Secretary of the Navy (Financial Management and Comptroller) acknowledged to us that material deficiencies still exist in the Navy Working Capital Fund financial statements. Therefore, we did not perform auditing procedures to determine whether material amounts on the financial statements were fairly presented. We did not perform these and other auditing procedures because Section 1008(d) of the FY 2002 National Defense Authorization Act limits the Department of Defense Inspector General to perform only audit procedures required by generally accepted government auditing standards that are consistent with the representations made by management. The Navy has also acknowledged, and prior audits have identified, the material weaknesses listed in the Summary of Internal Control. These material weaknesses also affect the reliability of certain information contained in the annual financial statements—much of which is taken from the same data sources as the basic financial statements.¹ Therefore, we are unable to express, and we do not express, an opinion on the basic financial statements. Additionally, the purpose of the audit was not to express an opinion on the information accompanying the basic financial statements. Accordingly, we express no opinion on the accompanying information.

¹ The annual financial statements include the basic financial statements, management discussion and analysis, consolidating and combining financial statements, Required Supplementary Information, and Other Accompanying Information.

Summary of Internal Control

In planning our audit, we considered Navy internal control over financial reporting and compliance. We did this to determine our procedures for auditing the financial statements and to comply with Office of Management and Budget guidance, but our purpose was not to express an opinion on internal control. Accordingly, we do not express an opinion on internal control over financial reporting and compliance. However, previously identified reportable conditions, all of which are material, continued to exist in the following areas:

- Accounting and Financial Management Systems
- Fund Balance With Treasury
- Accounts Receivable
- Inventory and Related Property, Net
- Accounts Payable
- Other Liabilities

Material weakness are reportable conditions in which internal controls do not reduce (to a relatively low level) the risk of misstatements that are material to the financial statements and that might not be timely detected by employees while performing their normal assigned functions.

Reportable conditions are matters coming to the auditor's attention that, in his or her judgment, should be communicated to management because they represent significant deficiencies in the design or operation of internal control, which could adversely affect the organization's ability to initiate, record, process, and report financial data consistent with the assertions of management in financial statements.

Our internal control work (conducted during prior audits) would not necessarily disclose all reportable conditions. The Attachment offers additional details on reportable conditions, most of which we consider to be material internal control weaknesses.

Summary of Compliance with Laws and Regulations

Our work to determine compliance with selected provisions of applicable laws and regulations related to financial reporting was limited because management acknowledged, and prior audits confirm, that instances of noncompliance continue to exist. The Assistant Secretary of the Navy (Financial Management and Comptroller) acknowledged to us that critical financial management and feeder systems do not comply with Federal financial systems requirements, Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level, as required under the Federal Financial Management Improvement Act of 1996. Therefore, we did not determine whether the Navy was in compliance with all applicable laws and regulations related to financial reporting. Providing an opinion on compliance with certain provisions of laws and regulations was not an objective of our audit and, accordingly, we do not express such an opinion. See the Attachment for additional details on compliance with laws and regulations.

Management Responsibility

Management is responsible for:

- preparing the financial statements in conformity with generally accepted accounting principles;
- establishing, maintaining, and assessing internal control to provide reasonable assurance that the broad control objectives of the Federal Managers' Financial Integrity Act are met; and
- complying with applicable laws and regulations.



Paul J. Granetto, CPA
Assistant Inspector General and Director
Defense Financial Auditing Service

Attachment:
As stated

Report on Internal Control and Compliance with Laws and Regulations

Internal Control

Management is responsible for implementing and maintaining effective internal control and for providing reasonable assurance that accounting data are accumulated, recorded, and reported properly; the requirements of applicable laws and regulations are met; and assets are safeguarded against misappropriation and abuse. Our purpose was not to, and we do not, express an opinion on internal control over financial reporting. However, we have identified the following material weaknesses and reportable conditions that could adversely affect a favorable opinion on internal control.

Material Weaknesses. Management acknowledged that previously identified reportable conditions, all of which are material, continue to exist.

Accounting and Financial Management Systems. Navy financial systems do not comply fully with generally accepted accounting principles and the U.S. Government Standard General Ledger at the transaction level. As a result, Navy financial management and feeder systems cannot provide adequate evidence supporting various material amounts on the financial statements.

Fund Balance With Treasury. Navy Working Capital Fund activities do not reconcile cash accounts to the Department of Treasury cash account balance on a consistent basis. In addition, system interfaces do not exist between the financial reporting systems, which results in unmatched disbursements and collections.

Accounts Receivable. Navy does not reconcile subsidiary records to corresponding general ledger accounts, resulting in a control weakness and the loss of an audit trail. Navy also posts unmatched collections to accounts receivable using journal vouchers, leaving no audit trail. Trading partner adjustments posted to intragovernmental accounts receivable are not always supported by detailed transactions. Navy also does not always record recognition and collection of public accounts for contract overpayments, travel advances, and employee debt.

Inventory and Related Property, Net. Navy Working Capital Fund Supply Management activities record inventory at latest acquisition cost. To comply with generally accepted accounting principles, latest acquisition cost must be converted to approximations of historical cost. Navy processes and methodologies do not accurately convert such approximations of historical cost.

Accounts Payable. The Accounts Payable line item is adversely affected by insufficient and inconsistent reconciliations and a lack of direct system interfaces, resulting in matching difficulties, undistributed disbursements, and the inability to capture trading partner information. Unmatched disbursements are transferred to accounts payable using journal vouchers, leaving no audit trail and often causing an abnormal balance.

Other Liabilities. Unsupported, undistributed disbursements need to be resolved. The Office of the Under Secretary of Defense (Comptroller)/Chief Financial Officer, the Defense Finance and Accounting Service Cleveland, and Navy staff need to work this issue jointly, analyzing amounts posted for contract accruals to determine whether they are properly recorded in this line item.

Effect on Reporting. These financial management deficiencies may adversely affect any decision by the Navy that is based, in whole or in part, on information that is inaccurate because of these deficiencies. Financial information reported by DoD may also contain misstatements resulting from these deficiencies.

Compliance with Laws and Regulations

Management is responsible for compliance with existing laws and regulations related to financial reporting. Our work to determine compliance with selected provisions of the applicable laws and regulations was limited because management acknowledged instances of noncompliance, and previously reported instances of noncompliance continue to exist. Therefore, we did not determine whether the Navy was in compliance with selected provisions of all applicable laws and regulations related to financial reporting. Our objective was not to, and we do not, express an opinion on compliance with applicable laws and regulations.

Federal Financial Management Improvement Act of 1996. The Navy is required to establish and maintain financial management systems that comply substantially with Federal financial management system requirements, applicable Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level. The Navy acknowledged to us that many of the financial management systems do not comply substantially with Federal financial management system requirements, generally accepted accounting principles, and the U.S. Government Standard General Ledger at the transaction level.

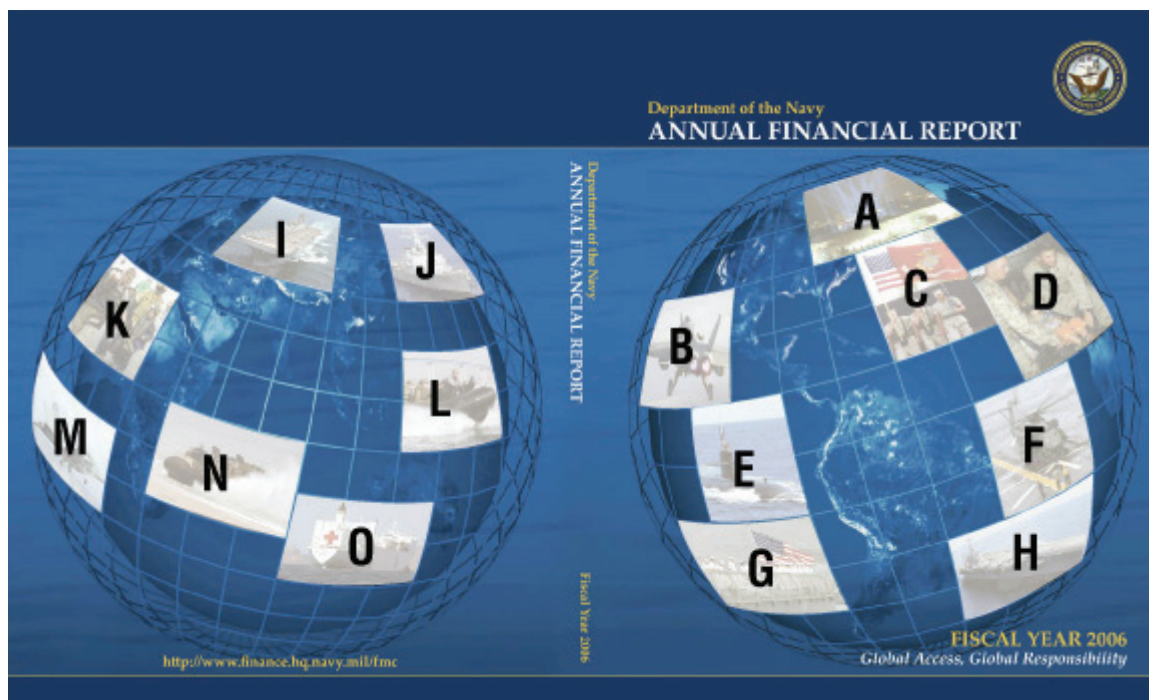
Federal Managers' Financial Integrity Act of 1982. The Navy is required to evaluate its systems of internal accounting and administrative control and to report annually on whether those systems comply with applicable requirements. The Navy performed an assessment of the effectiveness of the Navy Working Capital Fund internal controls regarding the reliability of financial reporting, compliance with applicable laws and regulations, and reliability of performance reporting. As a result of this assessment, the Navy identified material weaknesses related to financial reporting of the following:

- Financial Reporting of Environmental Liabilities,
- Financial Reporting of Military Equipment,
- Financial Reporting of Inventory and Operating Materials and Supplies,
- Financial Reporting of Fund Balance With Treasury, and
- Financial Reporting of Real Property Assets.

Audit Disclosures

The Assistant Secretary of the Navy (Financial Management and Comptroller) acknowledged to us on November 8, 2006, that the Navy Working Capital Fund financial management systems cannot provide adequate evidence supporting various material amounts on the financial statements. Therefore, we did not perform detailed testing related to previously identified material weaknesses. In addition, we did not perform audit work related to the following selected provisions of laws and regulations: Provisions Governing Claims of the United States Government, Pay and Allowance System for Civilian Employees, the Antideficiency Act, and the Federal Credit Reform Act.

This report does not include recommendations to correct the material internal control weaknesses and instances of noncompliance because previous audit reports contained recommendations for corrective actions, or audit projects currently in process will include appropriate recommendations.



FRONT COVER

Images from top to bottom, left to right:

- A: Washington, D.C. (Sept. 11, 2006) – One Hundred Eighty-Four beams of light projected from the Pentagon courtyard commemorate each life lost at the Pentagon on the five-year anniversary of the Sept. 11 terrorist attacks. *U.S. Navy photo by Chief Mass Communication Specialist Johnny Bivera*
- B: Indian Ocean (Aug. 22, 2006) – An F/A-18C Hornet assigned to the “Knighthawks” of Strike Fighter Squadron One Three Six (VFA-136) launches aboard the nuclear-powered aircraft carrier USS Enterprise (CVN 65). *U.S. Navy photo by Lt. Peter Scheu*
- C: Beirut, Lebanon (July 22, 2006) - Marines from the 24th Marine Expeditionary Unit’s (MEU) Command Element (CE) and the MEU Service Support Group (MSSG) assist the departure of American citizens from an Evacuation Control Center (ECC) in Beirut. *U.S. Marine Corps photo by Lance Cpl. Andrew J. Carlson*
- D: Beirut, Lebanon (July 21, 2006) - Sailors assigned to the transport dock ship USS Trenton (LPD 14) assist two young American citizens as they arrive aboard the ship from Lebanon. *U.S. Navy photo by Lt. Karen Eifert*
- E: Pacific Ocean (July 25, 2006) - USS Key West (SSN 722) sails in formation with a group of 28 ships and submarines at the conclusion of Exercise Rim of the Pacific (RIMPAC) 2006, the world’s largest biennial maritime exercise. *U.S. Navy photo by Mass Communication Specialist 1st Class M. Jeremie Yoder*
- F: Caribbean Sea (Aug. 26, 2006) - An MH-53E Sea Dragon prepares for take-off from the flight deck to conduct mine countermeasures. *U.S. Navy photo by Mass Communication Specialist Seaman Christopher Newsome*

- G: Novorossiysk, Russia (Sept. 7, 2006) - The Sailors aboard the guided missile frigate USS Elrod (FFG 55) man the rails as the ship pulls in to Novorossiysk, Russia. *U.S. Navy photo by Mass Communication Specialist 2nd Class Michael Lavender*
- H: South China Sea (May 8, 2006) - The Nimitz-class aircraft carrier USS Abraham Lincoln (CVN 72) and aircraft assigned to Carrier Air Wing Two (CVW-2) perform an aerial demonstration in the South China Sea. *U.S. Navy photo by Photographer's Mate 3rd Class Jordon R. Beesley*

BACK COVER

Images from top to bottom, left to right:

- I: Arabian Sea (Sept. 7, 2006) – The amphibious assault ship USS Iwo Jima (LHD 7) conducts flight operations in the Arabian Sea. *U.S. Navy photo by Mass Communication Specialist Airman Michael Minkler*
- J: Gulf of Aden (Aug. 29, 2006) – The guided-missile destroyer USS Cole (DDG 67) underway patrolling the Gulf of Aden as part of the Iwo Jima Expeditionary Strike Group (ESG). *U.S. Navy Photo By Mass Communication Specialist Seaman Christopher L. Clark*
- K: Beirut, Lebanon (July 21, 2006) - Sailors assigned to the transport dock ship USS Trenton (LPD 14) assist two young American citizens as they arrive aboard the ship from Lebanon. *U.S. Navy photo by Lt. Karen Eifert*
- L: Coronado, Calif. (Jan 12, 2006) - Marine Staff Sgt. David Cleaves, an instructor with Expeditionary Warfare Training Group Pacific, drives a Combat Inflatable Craft, (CRIC), with soldiers from Japan Ground Self-Defense Force (JGSDF) during Exercise "Iron Fist." *U.S. Navy Photo by Photographer 2nd Class Erich J. Ryland*
- M: Fighter Squadron One Zero Two (VFA-102) launches off the flight deck during flight operations aboard USS Kitty Hawk (CV 63). *U.S. Navy photo by Mass Communication Specialist Seaman Joshua Wayne LeGrand*
- N: Hat Yao, Thailand (May 15, 2006) - Landing Craft Air Cushion Five Eight (LCAC-58) assigned to Assault Craft Unit Five (ACU-5), arrives on the beach in Thailand as part of the 25th anniversary of the annual U.S./Thai exercise Cobra Gold 2006. *U.S. Navy photo by Journalist 2nd Class Brian P. Biller*
- O: Dili, Timor Leste (Aug. 29, 2006) - The Military Sealift Command hospital ship USNS Mercy (T-AH 19) sits off the coast of Dili. *U.S. Navy photo by Chief Mass Communication Specialist Edward G. Martens*

*Special thanks to **Admiral Gregory Smith**, the Chief of Naval Information; **Mr. Christopher Madden**, the Director of the Navy Visual News Service; **Lieutenant Christopher Bishop**, the Deputy Director of the Navy Visual News Service; and the **staff of the Office of the Chief of Naval Information** for providing Department of the Navy photographs.*

Many thanks also to the Financial Operations Team at the Department of the Navy (DON) Office of Financial Operations, the extended financial community at the DON major commands, and our accounting partners at the Defense Finance and Accounting Service for their dedicated time and effort in producing the Department of the Navy Fiscal Year 2006 Annual Financial Report. This FY 2006 Department of the Navy Annual Financial Report is dedicated to the men and women of our Navy and Marine Corps war-fighting team.



Department of the Navy
ANNUAL FINANCIAL REPORT

FISCAL YEAR 2006
Global Access, Global Responsibility



<http://www.finance.hq.navy.mil>